December 1956

THE CANADIAN CHARTERED ACCOUNTANT

THE CANADIAN INSTITUTE OF CHARTERED ACCOUNTANTS

Capital Gains

Key Steps in Preparing the Budget

Accountancy of the Future

Inventory Valuation - Theory and Practice

Prospectuses and Ontario Securities Act

Statistical Theory in Test Checking

ACCOUNTING RESEARCH • THE TAX REVIEW • CURRENT READING
ADMINISTRATIVE ACCOUNTING • STUDENTS DEPARTMENT

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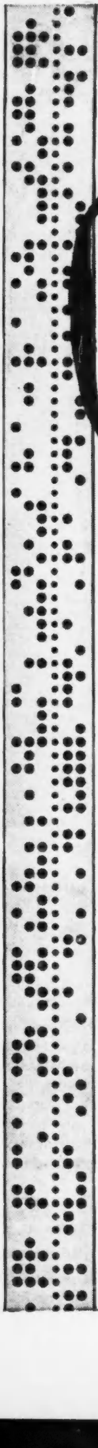

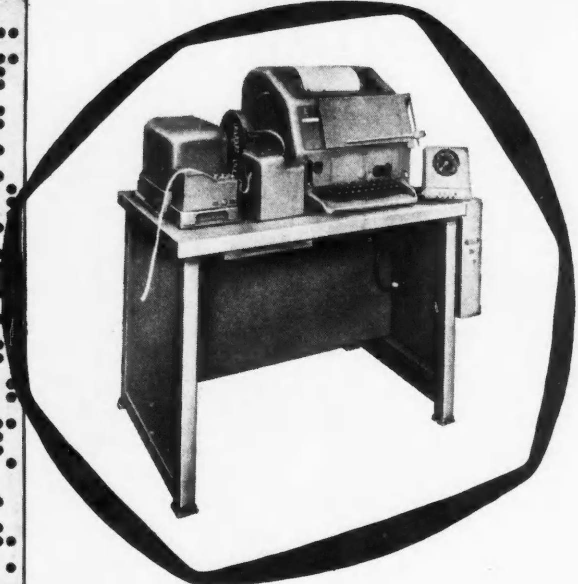

SEE CASE HISTORY ON FACING PAGE ▶

THE CANADIAN
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VOL 69, NO. 6, DECEMBER 1956

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IN THIS ISSUE

D. C. HIGGINBOTHAM, C.A.

The author of "Prospectuses and the Ontario Securities Act", D. C. Higginbotham, told the Editor that he had written the article on the regulation of prospectuses because of his interest in the problem of proper financial reporting to potential investors in Canadian industry. While the Ontario Securities Act will most frequently affect persons and companies in Ontario, companies incorporated in other Provinces and in the United States must file a prospectus conforming with Ontario law before its securities of primary issue may be traded in Ontario.

Mr. Higginbotham is a member of the Institute of Chartered Accountants of Ontario and received his certificate in 1951. He is on the staff of Price Waterhouse & Co., Toronto.

H. R. BALLS

One of the main topics of conversation in the early part of each year is speculation about the content of the Minister of Finance's budget speech which brings into focus the financial program and policy of the government for the year ahead. Few people realize the vast and complex amount of work that is done prior to its presentation, a continuing process which extends throughout the greater part of the year. In his article "Key Steps in Preparing the Budget" H. R. Balls sets forth some of the more important factors which have to be taken into account before the general financial and budgetary policy of the government can be determined. The services of many department officials are called upon and the author describes the various steps which are taken to make sure that the best available forecasts of economic and business conditions are readily at hand.

Mr. Balls is director of the Financial Administration and Accounting Policy Division of the Federal Department of Finance. He was recently appointed a director of the Northern Ontario Pipe Line Crown Corporation. In 1946 he received the Haldane Medal of the British Institute of Public Administration. This year he was awarded the gold medal of the Professional Institute of the Public Service of Canada which is given for contributions to national and international well-being in fields other than pure or applied science.

R. D. THOMAS, C.A.

Businessmen and accountants have given much thought to the question of inventory valuation, and no one method can possibly be suitable for all the varied types of industries and products in existence today. In "Inventory Valuation – Theory and Practice" R. D. Thomas has attempted to show what relationship exists between the theoretically desirable methods of inventory valuation to those which have actually been found in use.

Mr. Thomas is director of staff training for the various offices across Canada of Riddell, Stead, Graham & Hutchison. His training and experience include a period of teaching at the University of British Columbia as Assistant Professor, Faculty of Commerce and Business Administration. He is a member of the Municipal Finance Officers Association and a past chairman, Vancouver Regional Group of the Institute of Public Administration of Canada. He is the

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author of numerous articles and has published "Budget Manual for British Columbia Municipalities" currently in use in British Columbia and "Introductory Accounting Practice Set" being used at the University of British Columbia and at Carlton College, Ottawa.

STUART D. THOM

Should there be a change in the law with regard to capital gains? In trying to come up with an answer to this controversial question, one suggestion about which a good deal is heard is that some statutory definition be drafted to allow the taxpayer to recognize the quality of the gain which he is contemplating. Is this task possible? According to Stuart Thom, the possibility of statutory intervention should not be ruled out. Persistent complaints, he feels, might provide the excuse for moving into a field of income that has hitherto been free of the tax collector.

In "Capital Gains", Stuart Thom outlines the situation with regard to capital gains on the Canadian scene – a state of affairs which he describes as one of confusion and uncertainty. His article refers to the various historical stages of income tax law in this country and quotes from the U.K. Royal Commission Report.

Mr. Thom is a partner of the legal firm of Osler, Hoskin and Harcourt, Toronto.

DEREK LUKIN JOHNSTON, C.A.

In "Some Tudor Auditors", Derek Lukin Johnston takes us back 400 years on a lighthearted excursion to Tudor times. There we find the forerunners of the accounting profession casting a disapproving eye on many a frivolous and unnecessary expense. Enthused by Mr. Lukin Johnston's

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discoveries we undertook a minor piece of research of our own and found that the calling of accountant was well looked on even in those early times and at least one King did not find it beneath him. In *The Merchants Mirrour* by Richard Dafforne of Northampton, published in 1636 and a highly prized volume in the library of the Institute of Chartered Accountants in England and Wales, it is recorded that "Noble Prince King Henry VII inspected the accounts in his Exchequer whereby he did strike a terror into the hearts of the officers".

Mr. Lukin Johnston is a past president of the Institute of Chartered Accountants of British Columbia and a partner in the Vancouver office of Price Waterhouse & Company. He has written a number of articles on the history of accounting.

E. L. PURSEY, C.A.

The use of statistical methods in test checking is a recent development in the technique of auditing. Much has been written on this subject already, so that in "Statistical Theory in Test Checking" E. L. Pursey has refrained from showing how statistical sampling is carried out. His intention has been to consider, from the point of view of the auditor in practice, some of the requirements needed if statistical methods are to be used, to make comparisons with usual audit practice in test checking and point out apparent weaknesses.

Mr. Pursey has been a member of the Institute of Chartered Accountants of Scotland since 1948. He is a member of the Institute of Chartered Accountants of Nova Scotia and is presently on the staff of Price Waterhouse & Co., Montreal.

NOTES AND COMMENTS

Members Directory Now Available

The C.I.C.A. Members Directory 1956-57 went on sale in the middle of last month and more than 700 advance orders have been filled. The directory, cloth bound and stamped in gold, contains the listings of members by province, an alphabetical listing for speedy reference, and a listing of accounting firms and sole practitioners by geographical location. Copies are available to members at a special price of $3.00. The price to non-members is $6.00. Those who have not yet placed their order are invited to use the convenient order form appearing on page 573 of this issue.

Pensions Brief

A brief on pensions for the self-employed has been submitted to the Hon. Walter Harris, Minister of Finance, by the Canadian Bar Association and the Canadian Institute of Chartered Accountants.

Westward Ho!

The next C.I.C.A. annual conference will take place from August 18 to 21, 1957 at the Bessborough Hotel in Saskatoon. Reappointed chairman of the Annual Conference Committee is Campbell W. Leach of Montreal. His co-chairman will be George G. Patrick of Saskatoon.

Accounting Research Reprint

In September 1956 the Accounting Research Department of this magazine contained an article entitled "Confirmation of Inventories, Liabilities and Life Insurance Policies" by Lawrence G. Macpherson, Director of Research of the Canadian Institute. A limited number of reprints of this article and its accompanying forms are now available and may be obtained without charge by writing to the Canadian Institute of Chartered Accountants, 69 Bloor Street East, Toronto.

Another Canadian to Participate in Amsterdam Congress

A note in last month's issue of *The Canadian Chartered Accountant* stated that James A. de Lalanne and J. Grant Glassco would be taking part in the technical sessions of the 1957 International Congress of Accountants to be held in Amsterdam next September. It has now been learned that Lawrence G. Macpherson, C.I.C.A. Director of Research, will deliver a paper on "The Internal Auditor".

Winning Annual Reports

The Bank of Nova Scotia was judged as having the best annual report of the Canadian Banks for 1955, in the final ratings by an independent board of judges in the 16th annual survey of *Financial World.* In the Canadian Banks classification The Toronto-Dominion Bank was runner-up for top honours, while The Royal Bank of Canada placed third.

One Taxpayer, One Pocket

The man in the street may have a rough idea of how much in taxes goes to the federal government (by way of

income tax, succession duties, corporation tax, manufacturer's sales tax, etc.) but he rarely realizes that provincial taxes also have to come out of his pocket. According to CCH Canadian Limited, these latter taxes will total almost a billion dollars next year. They include provincial gasoline tax ($263 million), sales tax levied by five provinces ($150 million), provincial succession duties ($61 million), amusement tax ($21 million), as well as Quebec corporation and personal income taxes ($91 million). The composite "provincial-federal" man who takes the odd drink will contribute some $131 million to the provincial revenue account. This represents the profit from provincial liquor sales.

American Accounting Association

C. A. Moyer of the University of Illinois was elected president of the American Accounting Association at its convention in Seattle. Also elected were Arnold W. Johnson of New York University, Herbert E. Miller of the University of Michigan, and Elmer G. Beamer of Haskins & Sells, Cleveland, vice-presidents; R. Carson Cox of Ohio State University, secretary-treasurer; Ralph L. Boyd of Portland State College, director of research.

Tax Foundation Meeting

Close to 500 attended the 10th annual conference of the Canadian Tax Foundation at the Windsor Hotel in Montreal on November 12 and 13. Six papers and eight panel discussions were arranged with speakers drawn from Canadian and U.S. industry, government and the universities. Some of the features on the program were:

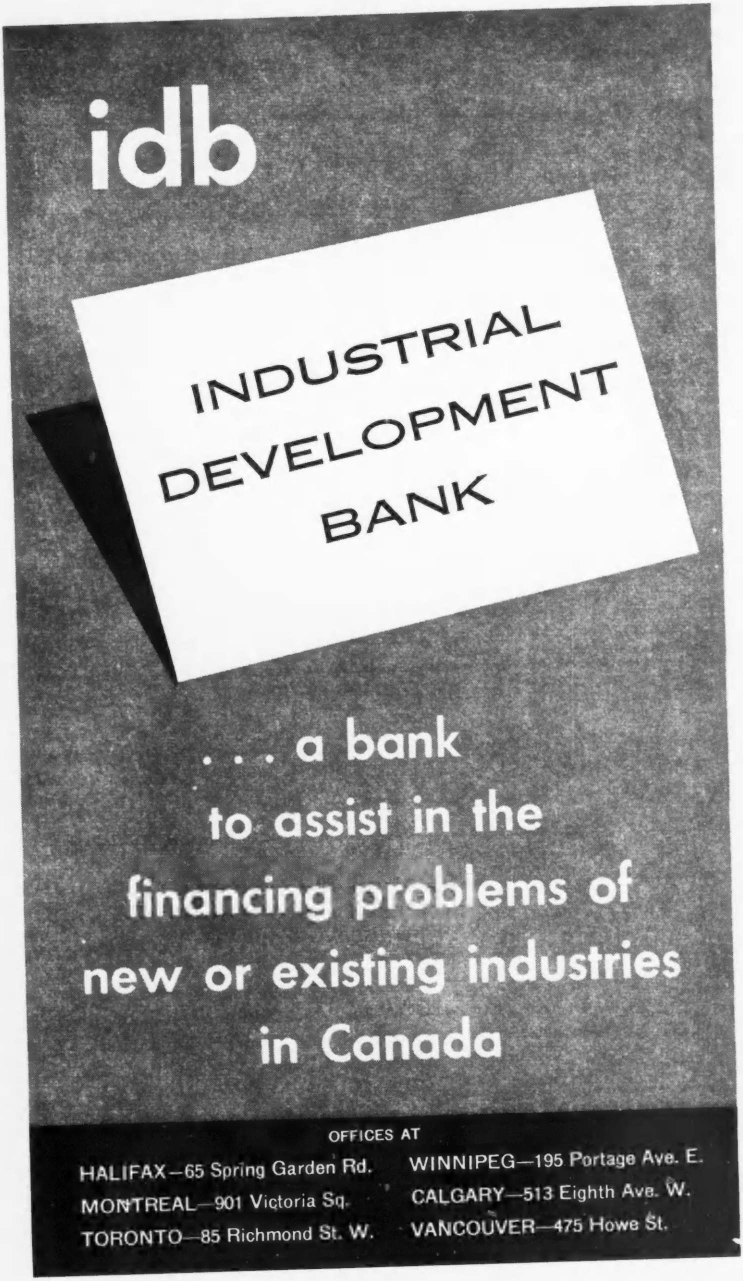
- "Taxation and Foreign Investment" discussed by Henry S. Bloch, Acting Director, Bureau of Economic Affairs, United Nations, New York; John F. Costelloe, Tax Director, Radio Corporation of America, New York; Monteath Douglas, Director, Canadian Office, National Industrial Conference Board, Montreal; and Paul S. Deacon, Investment Editor, Financial Post, Toronto.
- "Federal-Provincial Tax Arrange- Clerk of the Privy Council, Ottawa, and Marcel Belanger, Secretary, Department of Commerce, ments" with papers by R. B. Bryce, Laval University.
- "Tax Administration" discussed by V. W. Holland, Comptroller of Taxation, Imperial Oil Limited, Toronto, and F. W. Watkins, Controller, Canadian Committee Office, Hudson's Bay Company, Winnipeg.
- A review of the sales tax report by the three members of the Sales Tax Committee.

Chartered accountants taking part in the discussions were K. J. Morrison of Calgary, C. L. King, L. J. Smith and A. J. Little of Toronto, and F. S. Capon and F. A. Coffey of Montreal. Topics included were Too Much Income Tax Law? Can Capital Gains Confusion Be Removed by Legislation? Pensions for the Self-Employed and Corporate Amalgamations under the Income Tax Act.

A report of the conference, containing a verbatim transcript of all papers and discussions, will be made available to members of the Foundation early in 1957.

In the News

An honorary degree of Doctor of Civil Law was conferred on CHESTER S. WALTERS at the fall convocation of Assumption University.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Editorial

THE GENERAL RECOGNITION OF ACCOUNTANCY AS A PROFESSION

E. Michael Howarth, C.I.C.A. Executive Secretary

THE AMERICAN Institute of Accountants recently published a study entitled "The General Recognition of Accountancy as a Profession" based on a survey made by their public relations counsel. While reading this perceptive and well-written brochure, one is struck by the extent to which the observations contained therein are germane to the profession in this country.

It is noted that the profession has never been the object of wide-spread suspicion, nor subjected to derisive characterizations. On the other hand, there is some evidence that accountants have yet to win general public recognition that they constitute a profession rather than a highly technical and specialized vocation. This is attributed to two main factors, namely, the recent development of the profession, in comparison with the long tradition of law and medicine, and the infrequency of its contacts with the general public.

One has only to consider the impact of the doctor and dentist on the imagination of a growing child to appreciate this latter point. In the case of the accountant, the contrast is illustrated by the story of the little girl who informed her daddy that she wished he was a butcher instead of a chartered accountant because "it would be so much easier to explain to my friends what you do". It has to be admitted that our profession does not lend itself easily either to exposition, or dramatic presentation. Its contacts are mainly with relatively small elements of the public, and even though its contribution has great significance for the whole economy, there is little likelihood of any national advertiser adjuring everyone to "see your accountant at least twice a year".

This study views the problem in terms of guiding the profession

"to an external recognition more nearly commensurate with its internal achievement", but if the common channels towards greater public appreciation and understanding are *ipso facto* closed to us, what alternatives exist? There appear to be several, and the possibilities are as inviting as they are challenging. In one area much has already been accomplished. The appointment of chartered accountants to important responsibilities has done much to enhance the prestige of the profession in recent years. A growing number have accepted posts of distinction in industry, in government, in finance, and in the many civic and philanthropic enterprises desiring the benefits of their judgment, experience and training. It is worth noting that, stemming from the rapid growth of recent years, approximately 75% of our 7,000 members are still under 40 years of age. It is reasonable to assume that as this larger group gains in maturity and experience, the complex nature of our expanding industrial economy will bring about a correspondingly marked increase in this type of appointment.

While we can take justifiable pride in this trend, there are scant grounds for complacency in our attitude towards the profession's public relations. Much remains to be done, and it may well be that any acceptance of the need to make a conscious effort will go against the grain for a group imbued with the professional man's natural antipathy towards anything smacking of propaganda or self-sought publicity. Fortunately, a grandiose and high-pressured campaign aimed at winning over the masses is not the answer. Instead, a steady, continuing exposition of the profession as an integral part of modern life is required to further the general awareness of its contribution, and its significance in the current scene.

Such a program will require the enlightened and enthusiastic support of the profession both individually and through its provincial and national organizations. A number of suggestions come to mind. One Institute has awakened the interest of high school students and secured the cooperation of teachers by a testing program designed to indicate the possibilities for success in chartered accountancy. Following the tests a friendly meeting is held at which members describe the opportunities in chartered accountancy. This project has created goodwill, while increasing the understanding of the role of the chartered accountant. High school "Career Days" present an excellent opportunity for telling our story. Do we take full advantage of them? A profession is judged, in part, by the quality of its literature. Encouraging progress is being made in this field, yet recent efforts to bring this journal to the attention of a wider readership have so far received the support of less than 5% of our members. Public ignorance of the operation of our economy is one barrier to broader understanding of the work of the chartered accountant. Are we sufficiently identified with efforts to educate the public in the workings of our economy?

A sense of public responsibility is one of the hallmarks of a profession. In fulfilling that responsibility our profession has so organized itself that the business community has come to associate the title "chartered accountant" with high standards of competence and conduct. A wider public awareness and appreciation will follow, if the profession assumes the further responsibility of revealing itself in those areas where its affairs genuinely affect the public interest.

A BACKWARD LOOK AND A FORWARD GLANCE

THIS DECEMBER issue will reach our readers in time for us to wish them all a very happy Christmas and it may not be inappropriate at this season to take a glance backward over the year now nearly ended and then turn for a moment towards the future.

In the sphere with which we are directly concerned there are a number of interesting happenings to recall, notably, the formation of three new Institute Committees on Public Relations, Ethics and Pensions, which were announced in our columns earlier this year. Professional and other self-employed people on this side of the Atlantic were filled with new hope for their own cause on learning that the 1956 U.K. Finance Bill contained a provision to allow their British counterparts to save for retirement on the same basis as is permitted to the great majority of taxpayers who are employees. The profession is deeply interested in the possibility of government legislation, which might provide some measure of tax relief in regard to pension premiums and an estimated 400,000 self-employed persons in this country would benefit from such legislation. Early in August the government passed a bill containing a number of important amendments to the Income Tax Act and a reminder that may be useful is that the Institute, together with the Canadian Bar Association, prepares a joint brief on recommendations for amendments to the Income Tax Act, which is presented annually to the Ministers of Finance and National Revenue. The Sales Tax Committee completed its report in the early summer after having heard submissions from 31 interested organizations. The interim report of the Royal Commission on Canada's Economic Prospects is now eagerly awaited. Both were headed by members of the profession, a further proof of how the services of chartered accountants are being called on.

The profession suffered a loss in September through the death of Maj.-General James G. Ross. He had been a member of the Quebec Institute for 72 years and was also one of the original members who organized the Canadian Institute in 1902. His long career spanned virtually the whole development of the profession in this country.

The Institute year has seen several events of particular interest to the profession. Members of the Quebec Institute celebrated the 75th anniversary of its formation and were honoured at their anni-

versary banquet by the presence of His Excellency, the Governor General of Canada. The British Columbia Institute also commemorated the 50th anniversary of its founding, having received its incorporation in 1905. More than 200 members attended the first annual two-day conference of the Institute of Chartered Accountants of Ontario at Queen's University, Kingston. A two-day annual conference was also held by the Institute of Chartered Accountants of Saskatchewan.

Turning to our own position, we are glad to report that with the publication of the November issue of *The Canadian Chartered Accountant* the magazine reached another important milestone. It carried more pages, had a higher circulation and attracted more advertisers than any number since publication began. In these days, when time for reading is so limited, the increased circulation is cause for considerable gratification and shows how we are growing with the advancement of the profession as a whole. As to the immediate future, with the coming of the new year, we are introducing one or two changes which we hope will be of particular interest to our readers. We have arranged for Mr. Willard Hamilton, C.A., of Montreal, to edit the monthly Tax Review feature beginning early next year. Mr. Hamilton is a vice-chairman of The Canadian Tax Foundation and many of our readers are already familiar with his work. He will succeed Mr. M. I. Pierce, LL.B. who has edited this department so ably for the past seven years. From time to time we plan to publish brief information on any new products in business which may be of particular interest to the profession. We also intend to distinguish next year's copies of the magazine by a change in the colour of the cover. It will continue to be our aim, under the guidance of the Canadian Institute, to disseminate information on subjects related to accountancy, auditing, taxation and financial management, which will be helpful to practitioners, lawyers and business men. To all who have helped to make this progress possible we extend grateful thanks. We are always glad to hear from readers who may have additional suggestions for still further improvements.

Accountancy of the Future

EDWARD W. NETTEN

We are greatly concerned these days with the development of new ideas in our profession. We have come a long way in the last 50 years —what will be the startling changes in the next half-century?

There is a tendency to think that accountancy is reaching full growth and that all the major steps forward have been taken, so that it remains only for the accountant of tomorrow to consolidate and refine our gains. So much illuminating literature has been published recently, so much progress made in theories, practices and standards that sometimes there appears to be little scope left for further development.

Perhaps our present position is analogous to that of physics at the turn of the last century. Physicists had neatly classified almost all scientific phenomena and had a plausible explanation for nearly everything that happened in the physical world. They thought their work was about over. Yet by 1910 the minds of Curie and Einstein had opened the door to a flood of undreamed-of discoveries and speculations.

So it may be with us. For accountancy is not an unchanging, independent art. It is pragmatic — its subjects are set out for it by the needs of business and government. As these needs change, accounting changes.

Certain it is that business will progress greatly in the years to come. The combined incidence of atomic power, the automatic flow of industrial operations through electronic control, improved knowledge of what makes people tick and a changing social climate is bound to have a vast effect. Taxation and governmental activities will likely increase in complexity. Accountancy must move in harmony with these changes.

Shall we, then, raise our eyes from our current work, sit back, and let our imaginations run free to prophesy what we and our successors shall be doing at the start of the next century? Let us try to fathom the future—always an attractive project.

Although the conclusions are put concretely and quite dogmatically, they are, of course, only one person's thoughts.

The Influence of Business

Since to ask "Where is accounting going?" is really to ask "Where is the economy going?", we must forecast the changes to come in commerce

and industry. The following significant developments may reasonably be foreseen:

1. A radical increase in mechanization and automatic production, distribution and control. The main catalysts for the increase will be electronic processing — automaton, and cheap use of atomic power.

2. The continued growth of giant corporations as the only means of amassing sufficient funds to make use of the maximum productivity and efficiency of electronics and power. This growth will be coupled with suburban and rural decentralization of industry. It will create many complex problems of administration and control.

3. A steady rise in standardization and simplification, necessary for the effective use of electronics and the techniques of mass production.

4. Far better understanding of human desires and motivations. A fuller comprehension of personal relations, attitudes, incentives and working conditions, leading to harmonious relations between management and labour.

5. A gradual expansion of the fields in which government is concerned. An increase in governmental regulation of private enterprise, stemming from recognition of the vital public interest in large corporations.

From these five developments will flow the important changes in accountancy.

Our Profession

The public accountant faces a fascinating future. A broad field is open to him, and his role as an independent adviser upon every matter relating to finance, control and administration will expand greatly. His will be a difficult job for he must know more and more about more and more.

There will be a further growth of the large accounting firm. Already it is nearly impossible for one man or a small group of men to master the diverse subjects of our work. Industrial size and ever-increasing complexity will encourage large practices with many specialists.

The need for competent accountants will grow tremendously, and so the position of the small practitioner will be maintained.

Perhaps we shall see the creation of a new type of accountant similar to Queen's Counsel; a man who, with highly specialized training in certain fields, offers his services on a consulting basis only to other accountants.

As industry broadens out on an international scale, our firms will too, in order to meet industry's needs. In recent years a few large firms have grown to the stage where they have world-wide practices, and many others have correspondents all over the globe.

Closer relations will develop among the corporate bodies of public accountants throughout the world. Affiliations will be arranged, qualifications will be substantially the same, reciprocal rights will be granted, research will be coordinated, ethical standards will be uniformly high. Possibly there will be a close international federation of the institutes and associations. The gradual trend to "one world" in the political and economic spheres will bring forth one world in our own fields.

As the profession grows in stature and approaches maturity, we must, in common with the other professions, create a philosophy to underlie our principles. Extensive and intensive

research will give birth to a philosophy, and the establishment of university centres of knowledge and study will foster it.

Electronics

Replacement of manual and mental labour with machine power will bring about the most fascinating of the changes in our profession. The day will come when all the manifold functions of making and selling a product can be handled automatically by electronics. A new concept will arise of the enterprise as a unit, with complete integration and correlation of all these functions.

Accounting will no longer be an independent business function, run on its own as a department feeding on papers and figures supplied by other departments. Rather it will be one element entering into integrated operations at various control points; for example, in planning through budgeting and pre-testing the effects of alternative plans, in purchasing by records of supplies and orders, in manufacturing by minute analysis of costs and variances, in selling through market and demand analysis, in finance by forecasts, collection of sales and payment of invoices and payrolls, and in administration through speedy analysis of operating results.

In terms of organization, accounting will be a part of many unified line functions rather than a staff function. Difficult though it may be to visualize now, all the traditionally accounting services can be performed as part of an integrated "production line" almost wholly automatic.

Accounting Theory

What changes in theory will there be? We might say, on first thought, not many. Have we not reached the point where, with one or two important exceptions, we prepare financial and operating statements and use administrative principles which are satisfactory to the business community? Yet this is not the answer.

In the immediate future we shall witness a consolidation of the many recent advances, an application of accepted theories to practice.

When we consider the tremendous progress made since 1900 with respect to the determination of income, valuation of inventories, depreciation principles, statement disclosure and a host of other things, it is difficult to accept that we shall not see many similar improvements in the years to come.

New theories will meet new conditions and will perfect our present answers to present conditions. No principle is sacrosanct in accounting, for every principle relies on conventions which are accepted only because they meet the needs of the economy. Accountancy's universal problem will be to keep in step with business as business changes, to re-examine its own basic assumptions and unhesitatingly discard them if they are outmoded in the light of the current day.

This article by Edward W. Netten, C.A. has been awarded third prize in the 1955-56 Article Writing Competition sponsored by THE CANADIAN CHARTERED ACCOUNTANT. The author re-*ceived his certificate in chartered accountancy in 1953, having won the C.I.C.A. gold medal for the highest standing in Canada in the final examinations. He is with the firm of McDonald, Currie & Co., Montreal.*

International conferences and congresses of accountants will produce a uniformity now lacking in the principles accepted in different countries.

Inflation

Research and experimentation will likely provide acceptable solutions to our most pressing problem of today, that of income determination, especially the treatment of the effect of inflation on reported annual earnings.

Most serious social and economic issues are involved in the accounting presentation of the influence of inflation. High reported earnings, taxes and dividends and low "real" economic earnings can portray a false financial position and erode private capital.

Eventually the economic "physical capital" concept of profits will prevail over the accounting "dollar capital" concept. Economists predict a continuous now-fast, now-slow inflation of prices and wages. In time, probably not until the situation is considerably more serious than it is now, the efforts of accountants, businessmen and government will produce a workable method of eliminating the inflation element from profits and stating capital employed in terms of current money.

Quite probably the techniques adopted will provide for the use of general price indices to restate property amounts at current cost levels and for depreciation on the revised amounts in determining earnings for reporting and tax purposes. Current selling prices will be matched with current costs in the earnings statement and inventories will be priced at current cost, the last-in-first-out basis of valuation falling into disuse as its purpose will be accomplished without distortion of the current asset position. The inflation increment excluded from earnings will be shown as an adjustment of the shareholders' investment.

These changes will have the effect of remeasuring capital employed in terms of the current purchasing power or investment opportunity of the now-depreciated money originally invested as share capital or through retention of earnings.

No adjustment will be made of the claims of holders of commercial and government bonds. It may be said that the loss of purchasing power is the holders' risk, and any adjustment proposed for them would have to include the holders of annuities, pensions and life insurance policies. Some bonds, however, may be issued with the incentive of a variation in value tied to price index changes.

Financial Reporting

Many changes may be foreseen in this field. A few are outlined below:

1. Presentation and content of annual financial statements will be more uniform. After the present period of testing and experimenting with various forms and terminology, we may anticipate a settling down of accepted practices. Efforts of the institutes of accountants, stock exchanges and governments through their acts regulating companies' statements should produce a consistency in treatment and language.

However, this applies more to form and terminology than to the principles upon which the statements are based. We may see a standard method for classifying the various items, and standard wording, more understandable to the layman, used for them. The narrative form of the statement of financial position (the only

form likely to be accepted world-wide) and the single-step all-inclusive form of the earnings statement may be adopted generally.

While we could hope that research and conscious attempts to obtain objective uniformity in such matters as bases of valuation and disclosure would narrow the area of permissible latitude in principles, the dynamics of business will make this unlikely. Ever-new developments in business-organization, taxation and the social and economic structure will cause continual experimentation and breed new and challenging ideas. Because of complexity and individual variations in conditions, the goal of full uniformity and comparability can never be reached.

Though we shall codify and systematize our principles and methods as time passes, we must admit continuous change and experimentation. Accounting must never become rigid and insensitive to changes in social and business conditions.

2. Annual reports will be directed not only to the shareholder, but also to the employees and the public. Usually one report and set of annual statements will suffice. The report will include appropriate details of wages and productivity and of sales prices and manufacturing and distributing costs as well as the usual financial figures, with highlights of operations for at least ten years. Graphs will play a prominent part. One of the more interesting tasks of management and the profession will be to design a report presenting the salient facts to all the interested parties without undue complication.

3. Financial statements will be more intelligible to the average person. Uniformity in form and terms coupled with dissemination of information on the purpose of the statements will bring general understanding of their uses.

4. The statement of financial position will come to be recognized as a document of considerable importance, not merely a repository of items not yet reflected in the statement of earnings. Changes within net current assets and their source and use will assume a prominent place in the review of a company's prospects. The restatement of property amounts in terms of current money will permit more significance to be attached to these amounts than is the case today, not as values, but rather in indicating assets employed and ratios of earnings to investment. Relations amongst current assets and current liabilities, capitalization, earnings, dividends and the flow of funds will be recognized as of the utmost importance.

5. It will be generally accepted that the value of corporate property lies in its going concern earning power, actual or potential, in its present or an alternative use. The amounts at which property assets are stated will be understood as a stewardship accounting for the portion of the investment in these assets which is not yet chargeable to earnings.

6. Audited quarterly reports to shareholders, employees and the public will become usual practice, brought about by requests for up-to-date data on which to base decisions and by improved and speedier reporting resulting from electronic processing.

7. The standards of reporting by non-profit enterprises — governments, institutions, and fiduciaries — will rise, and lead to much greater clarity of form and disclosure.

Administrative Accounting

Here we shall see many amazing changes in principles and procedures, such as the following.

1. A vast improvement in financial control of operations is foreseen. Refinement of control will come through comprehensive financial forecasting, including fuller use of flexible budgets, detailed analysis of variances from budgets and quick presentation of reports to executives only on items requiring action or of special interest.

The use of electronics will enable pre-testing of planned programs in such a thorough manner as has never before been possible.

Techniques for interpretation of operating results will be greatly improved.

2. Universal understanding of the controller's role will enlarge the scope of his work and make him more often than not a member of top-level policy management.

3. The controller's staff will be occupied largely with analyses of reported results, budgeting and special reports on any division of the business requiring study.

The function of running the electronic accounting machines and processing prior to analysis will be relegated to separate personnel, specialists in this work.

4. As the benefits of large scale centralized electronic accounting are introduced, there will be a gradual reversal of the present trend to decentralize accounting. Administrative control and data processing will be centralized; administrative responsibility will be decentralized. Although the central office will process the original data and interpret it for top management, staff at each location will analyze the processed data for the management there.

5. Accounting systems will be further standardized within industries through the medium of trade associations. Compilation of industry averages will allow each company to see how its results compare with those of the rest of the industry and will provide valuable data for the economist.

6. There will be increased use of the marginal income concept and direct costing in making operating decisions but not for inventory and earnings costing purposes. The "value added" principle will be used more than it is now in operating analyses and in negotiations with labour unions.

7. Income control — the scientific setting of prices — aided by thorough market study will rank equally in significance with cost control.

8. Standardization of size and data arrangement of invoices, orders, shipping advices, payroll papers and the multitude of other business forms will relieve enormously the burden of office routine and eliminate the preparation of many documents. Many papers will be used in the accounting machines of the receiving company without further processing.

Auditing

The independent auditor's position will change significantly. As the use of machines for recording routine transactions is perfected, he will become more and more concerned with principles and their conformity to accepted practices.

New techniques will establish the reliability of records produced electronically. It is likely that the operation of the machines can be so ar-

ranged that internal control is virtually foolproof. Very small sampling tests, similar to product quality control, coupled with thorough budgeting and analysis of variations of results from the estimates will suffice to show the accuracy of the records.

Internal audit will expand into a management policy audit. The aim will be to ensure that all activities of the organization adhere to the policies laid down by management and are operating as effectively as possible.

The independent auditor's public responsibility as keeper of the business conscience and in reporting on management's stewardship will be recognized as of even greater importance than it is today.

The suggestion that the auditor should report not only on operating results as expressed in figures, but also on the efficiency of management will not come to fruition. No auditor, no matter how skilled, can effectively report on the ability of the management of many diversified companies, necessarily devoting a limited amount of time to his examination.

Management Consulting and Other Services

The field of consulting services, now opening up, will grow tremendously in scope and volume. On our own or in partnership with experts on production and distribution we will be recognized as the people best able to give business the advice its asks on administration and control.

These services will include the design of accounting and control systems, administrative techniques, wage, pension and incentive schemes, tax advice and financial planning.

Other diversified services will be rendered, such as the valuation of business enterprises, reporting in prospectuses, financial investigations, bankruptcies and liquidations, estate planning and acting as directors of companies and on charitable committees and governmental commissions.

Taxation

In this field, standardization and simplification are the keynotes.

International discussions and a multitude of legal cases on the nature of taxable income should lead to a large degree of uniformity. As the concept of income is clarified, existing law and cases will be further codified and income redefined in the simplest manner possible. Nevertheless, equity and the intricacies of our economy will require that our tax laws be very complex and comprehensive.

The present difficulties between lawyers and accountants relating to their respective work in the area of taxation will dissolve when amicable discussions lead to a clear delineation of the jurisdiction of each profession.

As the years pass and understanding grows between businessmen and the tax authorities, business income and taxable income should approach congruence. The tax people may place more reliance upon the audited annual statements and come to accept the earnings shown by these statements as taxable income, subject only to various economic incentives.

We shall probably see greater use of variations in the computation of taxable income and tax rates as economic levers. These will consist of such things as special tax allowances on new buildings and equipment, exemption of new companies in certain fields such as mining from tax,

and the lowering of tax rates in periods of low economic activity.

It is unlikely that a capital gains tax will be imposed in Canada or the United Kingdom. This tax is very difficult to administer and not greatly productive of fiscal revenue. However, if such a tax is levied as Canada matures and the need to attract investment capital lessens, the scope of the accountant's tax work will be greatly enlarged.

The Government

In accord with the times, the functions of our governments will continue to expand.

Increasing regulation of business enterprise is to be expected. Company dealings, share issues, annual financial statements, monopolistic and restrictive practices all will come under tighter control. The accountant will have a good deal of absorbing work with both business and government as clients.

English accountants have had much intensely interesting work in connection with the nationalization and denationalization of some of their industries. In North America there will be a growing volume of work relating to capital expenditures on public schemes and the like, investigative commissions and examination of the administrative procedures of government departments and the armed forces.

The Public

Programs undertaken by the accountants' institutes will promote a better understanding of our work by the layman and bring about fuller comprehension of our role in society.

Education and Training

Recruitment of capable personnel for the profession will always be a challenging and difficult problem.

Standards of qualification probably will be even higher and more exact than they are today. We may expect that eventually a university degree will be a prerequisite to qualification. Emphasis will be placed upon a liberal education with subject matter including English literature and composition, economics and philosophy as the essential foundation of an accountancy career. Without this the accountant of the future, no matter how skilled he may become in a particular line, will be merely a technician. With a broad underlying education it will be easy for the student to become skilled in the fields he chooses, through specialized study combined with experience.

As accountancy becomes more and more intricate we must accept that it is not practicable to become skilled in all or even many of its branches. After obaining a broad general education and acquiring a background of accounting theory, the student necessarily will concentrate on one or two branches which he wishes to make his life career.

Courses in administration and controllership must be prepared and offered on a par with the present courses in auditing, financial accounting and costing, in order to train the student properly for the fields he will enter.

An internship program – the combination of university classes with on-the-job training – will not grow except in postgraduate instruction, for the undergraduate university education will be, above all, a cultural education in the arts and sciences to fit each student for the art of accounting, not to make him skilled

only in its technique and science. There will likely be a large rise in the number of universities offering postgraduate programs leading to master's and doctor's degrees in accountancy and administration.

A Maturing Profession

The fields open to our profession will expand indefinitely and we shall ever grow in standing in the eyes of the community.

With opportunity goes responsibility. As the profession matures we must do all in our power to use our deepening responsibility wisely, and further to enhance our stature. A philosophy must provide a foundation for and dignify the art and science of accountancy.

The challenges of the future are even greater than those of the accounting pioneer days 50 years ago. Insofar as the profession keeps pace with progress and serves well the community, it shall receive the prestige and confidence it desires.

PROFESSIONAL ETHICS AND THE PUBLIC INTEREST

Professional ethics form a small part of a complex system of discipline which civilized society has imposed on itself through laws, customs, moral standards, social etiquette – rules of many kinds, enforced in many ways. Discipline is necessary, if people are to live closely in large numbers, to restrain the predatory instincts with which man is born.

The assurance that such discipline exists is the basis of man's faith in his fellow man, which, despite frequent disappointments, is essential to continuation of the highly involved economic structure which now supports most of the population of the western world

A code of professional ethics signifies voluntary assumption of the obligation of self-discipline above and beyond the requirements of the law. It thus serves the highly practical purpose of notifying the public that the profession intends to do a good job in the public interest. In effect, the existence of the code proclaims that in return for the faith which the public reposes in members of the profession, they accept certain obligations to behave in a way that will be beneficial to the public.

The ethical code also serves the purpose of providing members of the profession with guides to the type of behavior which the historical experience of the group as a whole has indicated is most likely to attract the confidence of the public.

A code of ethics is therefore a practical working tool. It is as necessary to a professional practitioner as his theoretical principles and technical procedures. Without a system of professional ethics he would be incomplete.

—From "Professional Ethics and the Public Interest", by John L. Carey, *The Journal of Accountancy*, November 1956

Prospectuses and Ontario Securities Act

D. C. HIGGINBOTHAM

THE ONTARIO SECURITIES Amendment Act, 1956, was passed at the recent session of the Ontario Legislative Assembly. It received royal assent on March 28, 1956, but included in its provisions was a transition period until July 1, 1956 during which time procedures followed under the old sections were acceptable to the Ontario Securities Commission.

The Securities Act regulates all security trading in Ontario, chiefly by exercising control over those engaged in trading activities. It provides for the filing of a prospectus before trading in securities involving a primary distribution to the public. It also sets out certain statutory information and the requirements for financial statements that must be included in the prospectus. The sections dealing with the financial statements are what the Securities Amendment Act has revised and these revisions are of particular importance to accountants and auditors.

The amendments were proposed initially by a Committee of the Institute of Chartered Accountants of Ontario with the assistance of representatives from the Ontario Securities Commission. Substantially all the revisions recommended by this committee were adopted. They incorporate current accounting thought on the requirements of financial statements in prospectuses and clarify and considerably improve the previous provisions. In addition, they eliminate certain differences between the Securities Act and the Ontario Corporations Act, 1953 so that accounting requirements under both Acts are now parallel.

The Province of Ontario has led the way in developing law governing the financial requirements of prospectuses. In preparing the revisions of the Act, it recognized that there is a wide variety of circumstances concerning each security issue and accordingly drew up the provisions in a flexible manner so that financial statements may be properly adapted to meet the needs of each individual case. This flexibility, however, places a considerable onus on accountants and auditors whose judgment must determine whether or not a set of financial statements provides a sound criterion for the prospective investor. The Ontario Securities Commission, which must approve all prospectuses, will require adequate reasons in support of the form of presentation before it gives its approval.

While the Ontario Securities Act will most frequently affect persons and companies in Ontario, federal companies and companies incorporated in other Provinces and in the United States must file a prospectus conforming with Ontario law before its securities of primary issue may be traded in Ontario.

Changes in the Securities Act

The amendments contained in the Securities Amendment Act relate to sections 38, 39 and 40 of the Securities Act. They cover every earnings statement, balance sheet, pro forma statement and pro forma balance sheet in a prospectus and include revisions of the auditors' requirements for reporting on these statements. The principal changes refer to the use of pro forma financial statements.

Where the proceeds of the security issue are being used to acquire a business, either a combined statement of earnings or a separate statement of earnings of the business being purchased is required in the prospectus; and either a pro forma balance sheet giving effect to the purchase or a separate statement of the assets and liabilities being purchased is also required. Both statements may be shown if the information would serve a useful purpose. These particular provisions illustrate clearly that the amendments are general in nature. It is the accountant's duty to take a general principle as stated in the amendments and see that it is appropriately applied to meet individual circumstances. The amendments likewise allow the Commission to require a pro forma balance sheet to give effect to the sale, issue or redemption of securities issued or to be issued and to such other transactions as they may require.

It is not possible to set out universal rules for determining which form of pro forma statement is most suitable, but some examples might illustrate the points which arise.

The assertion is frequently made that, unless individual circumstances indicate otherwise, combined earnings statements and pro forma balance sheets are preferable to individual statements. However, combined earnings statements should perhaps not be used by companies that have followed different accounting practices in matters of depreciation, claiming capital cost allowances, if, after acquisition, it is planned to change the practices of the acquired company. Likewise, where the purchase of a business is being financed by the issue of a long-term debt, a combined earnings statement does not reflect the cost of servicing the debt.

It is the accountant's responsibility to determine the most suitable disclosure of financial information in each case so that the Securities Commission will approve the most desirable form of statements.

A revision of the Act requires that the earnings statement shall be for a period of five years, plus the portion of any uncompleted year, or for such *shorter* or longer period as the Commission may require, but not for a longer period than five additional years. Previously, there was the same overall limit of ten years in the Act but the minimum requirement was three years, rather than five, and the term "for such shorter period as the Commission may require" did not appear. The majority of accountants recommending this revision felt that a period of longer than three years was required but that periods beyond ten years would be of little value in pro-

viding a criterion of future earnings.

In practice, it would appear that unless there are special circumstances the Commission will require a ten years earnings statement in the prospectus. Yet two examples of special circumstances do suggest a shorter period. It would be misleading to present earnings statements of integrated oil companies in the years prior to 1947 as those companies were operating then under quite different circumstances. Also, to show earnings from a portion of a business which has been sold recently and the proceeds used to retire preferred shares is perhaps misleading as the earnings would hardly be suitable for use by a prospective investor.

The balance sheet is now required "at a date not more than 120 days before the date of the prospectus or such other date as the Commission may accept", whereas previously it was required "at the end of the last completed financial year of the company or as at a date not more than 120 days prior to the date of the prospectus, whichever was the later date, or as at such other date as the Commission may approve". There is a normal interval between the date of a balance sheet and the date of a prospectus because of the time necessary to prepare and audit the balance sheet. Under the previous provisions of the Act it was necessary to obtain special permission from the Commission to use an earlier balance sheet if the year-end occurred during this time interval.

Now the earnings statement is required to precede the balance sheet, similar to the order prescribed in The Ontario Corporations Act. Formerly the balance sheet was normally presented first.

Where there are subsidiaries, the Act requires, as before, that consolidated statements be used, unless the Commission directs otherwise. However, where subsidiaries are not consolidated, a new provision requires disclosure of the interest of the company in the profits or losses of subsidiaries and the extent to which that interest is included in the earnings statements being reported upon, unless the Commission directs otherwise.

There is an important difference between the Ontario Securities Act and the Companies Act, 1934 in respect of consolidated statements. Under the latter, consolidated statements are required and there is no provision for the exclusion of subsidiaries, other than by Court order, whereas under the Securities Act the Commission may direct that the subsidiaries should be excluded. In some instances, especially where there are large minority interests in subsidiaries, consolidated statements are not useful, and the Ontario Act is more adaptable to these circumstances.

Under the revised Securities Act the board of directors of a company coming within the Securities Act must approve all prescribed financial statements, and the approval is to be evidenced by the signatures of two authorized directors at the foot of every balance sheet and pro forma balance sheet. Similar to the provision in section 92 of the Corporations Act, 1953, this regulation is preferable to the former provision where only the balance sheet had to be approved.

Content of Financial Statements

The Securities Act leaves the particulars on the form and content of financial statements to the jurisdiction

of the Securities Commission. The amended Act requires that the financial statements. . . . "be drawn up in such a manner and contain such information as the Commission may from time to time require". This is substantially similar to the previous provision that the financial statements should be in a form acceptable to the Commission. The Commission has issued notes on "Financial Statements of Mining and Industrial Companies" which, although not actually a set of regulations, are indicative of what the Commission will require. Except for the manner of disclosing interest charges in the earnings statement, these notes reiterate material contained in Bulletins Nos. 1 and 2 of the C.I.C.A. Committee on Accounting and Auditing Research, which cover standards of disclosure in annual financial statements and minimum standards which should apply in respect of prospectuses.

Practical Problems

The flexibility of the Act in respect of pro forma statements, the number of years of the earnings statement and the disclosure of information within the statements present certain practical problems. There are often differences of opinion as to what disclosure is best and a company should discuss the question with its auditors. Final approval of the prospectus is required from the Commission and to avoid delays, pre-filing conferences should often be arranged with the Commission to consider proposed forms of presentation. The Commission should be furnished with a draft of the financial statements showing the proposed form of presentation together with reasons for the form. (The figures need not be complete or final.) The Commission will normally indicate the form acceptable to it in these preliminary discussions and thus final clearance can be obtained more expeditiously.

The Commission may rely on the omnibus statement required from the directors that the prospectus represents full, true and plain disclosure of all material facts as a means of ensuring adequate disclosure of financial information.

Auditor's Report

The requirements of the form of the auditor's report has been changed to comply with the phrasing in section 82 of the Ontario Corporations Act, under which the auditor must report whether, in his opinion, the financial statements submitted present fairly the operations of the company for the years and period covered. This amendment eliminates the necessity of meeting separate requirements in reporting on a company's statements under Ontario law. The auditor now has to file a consent to the use of his report in the prospectus. This ensures the Commission that he has checked the final statements appearing in the prospectus and places some emphasis on the fact that he should review all financial information contained in the prospectus to determine that it is consistent with the financial statements being reported upon. As before, the auditor is required to make such examination as will enable him to report on the financial statements in the prospectus and he must be a person acceptable to the Commission.

Some of the redrafted provisions affect only mining companies or investment companies. For mining companies separate disclosure is required in the balance sheet of the value of shares issued for (1) cash (2) properties, claims or leases and (3) other

consideration. While this information was previously required in the prospectus, it was not a specific requisite of the balance sheet. The statement of surplus of investment companies shall now be for the same period as the earnings statement, rather than a period of one year as before, and the auditor is required to report on the statement of surplus as well as the other financial statements.

In actual fact, most of the accounting requirements of the new Securities Amendment Act, 1956 have been followed in recent prospectuses because the accounting profession and others have realized their obligation and responsibility to disclose related financial information properly. The Ontario Securities Commission has insisted on this adequate disclosure and has required the information it regarded as necessary. However, consideration must be given in future prospectuses to the technical changes contained in the amendments relating to the financial statements and the auditor's report.

DEFINING A PROFESSION

I never quite know where one draws the line between what is a profession and what is an occupation, or what is a trade, or what is, very monosyllabically, a job. . . . but there are three or four criteria which might be applied. One is that in order to be a profession and not an occupation or a job, those who practise it must themselves be in a position to control admission to it and to exercise discipline within it. That is the traditional mark of a profession. Another thing one would like to feel about all professions and all professional men is that they are, in one sense or another, independent. And that they recognize a duty not only to their clients (or their patients, in the case of doctors) but also to the community at large.

Sometimes they find themselves in a situation in which the duty to an individual client might be somewhat at conflict with the duty to society; and that must be a very difficult and dangerous position for any man to be in. In those circumstances, a member of a profession would feel that he had these duties; that he was independent, in the sense that he was not bound hand and foot, and blindfold, in the interests either of an individual client or of society. It follows from that, that members of a profession are, in their own line, genuine guardians of public and private honour.

—From an address by Sir John Wolfenden, C.B.E., M.A. to the Chartered Accountants Students' Society of London and published in *The Accountant*, November 10, 1956.

Key Steps in Preparing the Budget

H. R. BALLS

ONCE A YEAR at 8 o'clock in the evening, usually in the latter part of March or early in April, the Minister of Finance rises in the House of Commons and moves "that Mr. Speaker do now leave the chair for the House to go into Committee of Ways and Means".

This is the formality that initiates the annual budget speech.

After reviewing the state of the Canadian economy and the financial operations of the government during the past year, the Minister proceeds to give his estimate of the expectations of the economy for the ensuing year, the government's expenditure program and requirements, anticipated revenue collections at existing tax rates, and proposals for tax changes. The budget speech, which brings into a single focus the whole range of the government's financial program and policies, ends one cycle of financial operations and begins another. It culminates a long period of study and preparation in which many individuals and all governmental departments are involved and in which many complex and sometimes conflicting considerations are resolved.

The procedure whereby the government's estimates of expenditure are prepared, considered and ultimately laid before the House of Commons by the Minister of Finance is an essential part of the budgetary process. However, before the work involved is described, certain underlying principles or concepts should be mentioned.

Underlying Concepts

In the first place, the budget is *an integrated financial plan,* and all its elements must be available, as far as possible, for consideration as a whole and at one time. In this aspect it is essentially a method of assigning priorities to competing demands, of correlating programs with resources, a device for matching ends with means.

In the second place, the budget is *an executive plan.* The executive government as a whole is responsible for its preparation and submission to Parliament and for any subsequent changes in it. Under the Canadian system of financial administration no private member or individual Minister on his own responsibility may initiate financial proposals in Parliament, introduce money bills, or propose any amendments to legislation that would entail additional expenditures. This

principle is affirmed in section 54 of the British North America Act which states:

> It shall not be lawful for the House of Commons to adopt or pass any vote, resolution, address, or bill for the appropriation of any part of the public revenue, or of any tax or impost, to any purpose that has not been first recommended to that House by message of the Governor General in the session in which such vote, resolution, address, or bill is proposed.

A third concept or principle is that of the budget as *an annual plan* for a single fiscal year. In the Government of Canada, the period runs from April 1 in one year to March 31 in the next. While Parliament has agreed that some expenditures, such as those for family allowances, old age pensions, provincial subsidies and tax rental payments and interest and other public debt charges should not be the subject of annual review and debate, authority for the major part of all the government's outlay must be obtained annually. This principle of annuality finds expression in section 25 of the Financial Administration Act which stipulates that all estimates of expenditure submitted to Parliament shall be for services coming in course of payment during the fiscal year.

Lastly, there is the concept of the budget as *a plan approved by Parliament.* Section 24 of the Financial Administration Act provides as follows:

> Subject to the British North America Acts, 1867 to 1951, no payments shall be made out of the Consolidated Revenue Fund without the authority of Parliament.

In a very real sense the preparatory work in connection with the budget is a continuous process extending throughout the entire year. On the one hand, the program requirements of the spending departments are under day-to-day scrutiny by departmental officials working in close cooperation with officials of the Treasury Board. On the other, the revenue potentialities of existing taxes, together with proposals for new taxes or for changes in existing taxes and tax machinery, are constantly reviewed by officials of the Departments of Finance and National Revenue in the light of representations received from interested individuals and groups and of government policy generally. However, there is a recognizable pattern and time phasing in the more formal or routine aspects of the annual budgetary process.

Role of the Treasury Board

The first step is taken in connection with the estimates, the preparation of which is the particular concern and responsibility of the Treasury Board. The Board, which is a committee of the Queen's Privy Council for Canada, consists of six Ministers, with the Minister of Finance as chairman. Its duties, among other things, include advising the Council on a broad range of matters relating to finance, revenues, estimates, expenditures and financial commitments, accounts, establishments, the terms and conditions of employment of persons in the public service and general administrative policy in the public service.

In June or July of each year the secretary of the Treasury Board takes the initial step towards the preparation of the estimates by asking the Deputy Ministers to submit departmental staff proposals for the ensuing year to establishment review committees and subsequently to put overall departmental estimates proposals

before the Treasury Board. He indicates the dates by which the establishment review committees are expected to complete their reviews and to make their reports and also when the estimates proposals embodying the approved establishment recommendations are to be in the hands of the Treasury Board.

Establishment Review Procedure

The establishment review procedure, introduced in 1954, is based on the premise that departmental staff and personnel requirements are key factors in determining the scope and scale of the government's administrative activities and its consequential cash or estimates requirements. As such, the study of staff needs is a logical and essential prerequisite to the study of the estimates proposals.

In each department, a committee is established, consisting of representatives of the Treasury Board, the Civil Service Commission and the department concerned, with the Civil Service Commission representative acting as chairman. When the departmental staff proposals for the year have been prepared, they are referred to the committee which, during August and early September, reviews them in detail. The committee takes into account the department's assessment of its functional responsibilities under existing and approved programs; government policies generally and their translation into terms of departmental priorities; the adequacy of work load allocations, recruiting possibilities and related staff considerations; and probable costs, not only in the narrow terms of payroll charges, but also in the broader sense of outlay for the equipment and facilities needed for the efficient employment of staff.

The report of the committee must be completed, and its recommendations as to the number and classifications of the employees required for each branch or division of the department must be put in the hands of the Minister of the department and the Treasury Board by the end of September. These may be accepted or rejected by the Minister. If adopted, they are incorporated in and form part of the department's estimates submission. If rejected, the submission will differ from the committee's report but the reasons for the difference will be known to the Board. In either case the Board will make the final decision which, once approved, will not be altered during the year except in cases of urgent and proven need and on the basis of a subsequent review when the supplementary estimates are under consideration.

Preparation of the Estimates

While the departmental staff proposals are being studied by the establishment review committees, the detailed preliminary and technical work involved in the preparation of the estimates is under way in the departments, where the data relating to the estimated requirements for the coming year are being collected from the various branch, division and field offices and collated at headquarters.

In September or October, after considering both the probable outturn of budgetary operations for the current year and the best available information as to current economic conditions and probable trends and developments, the Minister of Finance writes to his colleagues enunciating the broad principles and policies to be followed by departments

in formulating their programs for the ensuing year. With this as a guide, the departments proceed to complete their estimates proposals for submission to the Treasury Board by the prescribed date, usually early in November.

When received by the Treasury Board, the departmental submissions are examined and analyzed. Comparisons are made with the expenditures of previous years, and digests of the supporting data furnished by departments and of other pertinent information are prepared so that the Board may be aware of the implications of the proposals and of any unresolved issues of substance arising from the submissions. Thus the Board is equipped to deal with any questions of policy or priority that may arise.

During December the Board reviews each departmental submission. It usually consults the appropriate Minister and calls departmental officials before it. It may reject or reduce an expenditure proposal but an unresolved issue will probably be referred to the Cabinet. When the Board is satisfied with the substance and form of the estimates, it submits them to the Cabinet for final consideration. After approval by the Cabinet the estimates are recommended to the Governor General, and at an early date in the parliamentary session, usually late January or early February, they are laid before the House of Commons by the Minister of Finance on behalf of the government with a message from the Governor General transmitting and recommending them to the House.

The Committee of Supply

On motion of the Minister of Finance the estimates are referred to the Committee of Supply, which is a committee of the whole House. In recent years it has been the practice to refer the estimates of certain departments to select committees of the House; for example, the estimates of the Department of External Affairs are usually considered by the Committee on External Affairs, and in 1955, and again in 1956, a Committee on Estimates was appointed to which the estimates of four or five departments were referred to permit a more intensive examination than the crowded schedule of the House allows. A report on these estimates is made by the committee to the House and they are then reviewed by the Committee of Supply. Prior study in the Committee on Estimates does not prevent a further detailed examination in Committee of Supply, although it generally shortens the time taken in the latter.

Consideration of the estimates usually extends over a period of several months. Each vote is the subject of a separate resolution, and members of the House may question the Minister on any item. When the examination has been completed the estimates, as approved by the Committee of Supply, are referred to the Committee of Ways and Means, also a committee of the whole House. This committee is asked to consider a resolution to introduce a bill raising appropriate moneys to meet the requirements approved in the Committee of Supply. When the resolution is approved, an appropriation bill is brought in which, after being passed by Parliament, is given royal assent and becomes law.

Kinds of Estimates

The main estimates, as they are called, are intended to provide fully for all the financial requirements of

the approved departmental programs for the entire fiscal year. Inevitably some requirements cannot be foreseen or accurately estimated when the main estimates are under consideration. Others arise out of new legislation passed by Parliament or as a result of programs approved by the Cabinet after the content of the main estimates has been settled. Consequently supplementary estimates are submitted to Parliament several weeks before the summer adjournment or prorogation. These are dealt with in much the same manner as the main estimates. They too are preceded by a review of supplementary staff requirements by the establishment review committees.

Two or three weeks before the end of the fiscal year it is also customary to introduce what are known as further supplementary estimates. These normally cover two functions. They provide funds for programs the requirements of which were underestimated when the estimates were prepared many months before. In addition, they authorize the reimbursement of Crown corporations and various government accounts, such as the agricultural prices support account, for deficits or losses sustained when such deficits or losses cannot be determined in time or with sufficient accuracy for inclusion in the main or supplementary estimates. The procedure for dealing with the further supplementary estimates is essentially the same as that followed for the main estimates except that no establishment review is made.

The further supplementary estimates are dealt with very promptly, but the procedure by which the main and supplementary estimates are debated in the House is time consuming. The process of scrutinizing the main estimates extends over a period of several months from the day they are first presented to the last day of the session.

This is usually some time after April 1 which is the beginning of the fiscal year to which the estimates relate, and although supply, as it is called, has not been passed by then, the functions of government must be carried on. To ensure that funds are available to pay the salaries of the government employees and to provide essential services, it is customary for Parliament to pass an interim supply bill granting one-twelfth or one-sixth of the total of each item in the estimates, roughly equivalent to the government's requirements for one or two months.

If the detailed consideration of the estimates is not completed before the funds provided by the interim supply bill are exhausted, one or more additional supply bills may be introduced. These will enable the government to carry on the public business until the estimates have been considered in detail and the necessary approval obtained.

Background for Preparing the Budget

The revenue potentialities of existing taxes and possible changes in current tax laws are likewise under continuous review throughout the year in the Department of Finance. Correspondence from the public and representations from interested groups flow unceasingly into the office of the Minister of Finance. These are all analyzed carefully by the Department, and the administrative problems and implications raised are reviewed with officers of the Department of National Revenue. However,

it is only several weeks before the main expenditure estimates are tabled in the House of Commons that the concentrated work on the preparation of the material for the budget speech and the associated budget papers is begun. A series of discussions and conferences is initiated ending with the decision by the Minister of Finance as to the precise form which his budget proposals will take. Background data is prepared on past and present economic conditions and on actual collections of governmental revenues for the current year. The best available forecasts of economic and business conditions and of tax and other revenue collections are obtained, together with calculations of the possible effects on prospective revenues of alternative rate and other tax changes.

Many factors are taken into account, such as the current level of economic activity generally; anticipated economic trends; estimates of national income and gross national product; industrial production, employment and labour income; agricultural production and farm income; exports, imports and the balance of trade; consumer spending and consumer credit; corporation profits, inventory levels; and residential and non-residential construction and other capital investment.

In the light of all this information and after consultation with his own senior officers in the Department of Finance and with representatives of the Departments of National Revenue, Trade and Commerce and the Bank of Canada, as well as with the other Cabinet members, the Minister of Finance determines his general financial and budgetary policy for the ensuing year. He decides whether he will budget for a surplus or deficit or to achieve a balance and what tax adjustments are advisable in the circumstances.

With this settled, the officials proceed to translate that policy into terms of taxes and tax legislation.

Budget Papers

In recent years it has been the practice for the Minister of Finance to table certain budget papers for the information of Parliament the day before he delivers his budget speech. These are in two parts. First is a general review of economic conditions for the preceding calendar year. It includes preliminary estimates of, and brief comments on, the more significant economic indicators, such as the national income and gross national product, personal income and its disposition; the source and disposition of savings; investment and capital expenditures; revenues and expenditures of federal, provincial and municipal governments; the balance of international payments; employment and earnings; monetary and credit developments; and price trends both at the wholesale and retail level.

The second part is a preliminary report on the government's accounts and financial operations for the fiscal year then ended or ending. It usually makes a brief summary of the budgetary revenues and expenditures and the resulting surplus or deficit for the year, a statement of the government's assets and liabilities at the year end with comment on the significant changes in the more important categories, and an analysis of the government's cash and debt position and the changes therein during the year.

The Budget Speech

With the budget papers in the

hands of members, it is now unnecessary for the Minister of Finance to review in detail in his budget speech the economic conditions prevailing in the country during the past year or to discuss at length the financial operations of the government during the preceding fiscal year. However, it is customary for him to say a few words about the international economic situation and major domestic economic developments.

A short section of the speech is usually devoted to a summary report on the government's accounts. It gives comparisons of the actual revenues and expenditures and surplus or deficit for the year with the forecasts given in the budget speech of the preceding year. There are brief references to the government's nonbudgetary transactions and the overall effect of budgetary and nonbudgetary operations on the government's cash and debt position. The Minister then proceeds to give a forecast of the probable financial requirements for the year ahead, taking into account the main estimates which are already before the House and making allowances for supplementary and further supplementary estimates to come and the probable lapsing or underspending in some appropriations.

After calculating the budgetary surplus or deficit he outlines what he considers is the appropriate tax policy for the ensuing year, and announces his proposals for increases or reductions in taxes and customs tariffs. If no changes are proposed all existing tax rates and customs tariffs remain in effect since it is unnecessary to re-enact the tax laws each year. If a change is proposed in a commodity tax on a particular item, it is usually made effective immediately.

At the close of his address, the Minister tables the formal resolutions for changes in the existing tax rates and customs tariffs. In accordance with parliamentary procedure this must precede the introduction of money bills. These resolutions give notice of the amendments which the government intends to ask for.

As previously mentioned, the budget speech is delivered in support of a motion that the House go into Committee of Ways and Means, but Parliament does not act on the budget proposals until the motion has been adopted. The debate on the motion to go into committee may extend over a period of several weeks although in accordance with the standing orders of the House, the actual proceedings must not exceed eight sitting days. However, once the motion is approved, the way is clear for the consideration of the budget resolutions. When all resolutions have been carried by the Committee of Ways and Means, they are reported to the House. Then the tax bills are introduced and dealt with in the same manner as all government financial legislation.

It is difficult to exaggerate the importance of the national budget in the economic life of the country, for it represents the point at which plans and policies are translated into concrete proposals for organization and action. A century ago William Ewart Gladstone said:

> "Budgets are not merely affairs of arithmetic, but in a thousand ways go to the root of prosperity of individuals, the relation of classes, and the strength of kingdoms." What was true then is equally true today.

Some Tudor Auditors

D. R. LUKIN JOHNSTON

"On Christmas Eve", said old Mr. Wardle to Pickwick, as the company gathered by a blazing fire and a mighty bowl of wassail, "everybody sits down, as you see them now — servants and all; and here we wait, until the clock strikes twelve, to usher Christmas in, and beguile the time with forfeits and old stories.

The nearness of our own Christmas season recalls the classic scene and suggests a momentary diversion from the austere professional monographs to which *The Canadian Chartered Accountant* very properly devotes its space. Let those who will draw a chair to the fire, take a cup of wassail (they may rely on historic precedent, as will be shown) and listen to a few "old stories" of our profession. If in the process a little good-natured fun is poked at the grammar and spelling of our ancestors, it is done in the sure knowledge that our own terms and usage will seem equally quaint to posterity.

We turn the clock back 400 years and find ourselves in the century of the Tudors. It may seem strange to find the auditor a well-known figure in the background of that glittering pageant of immortal poets, priests, sailors and soldiers. Perhaps he was an essential feature of the age, a counterweight, a fireman with a bucket to preserve the State from combustion by the rockets and fireballs of the English Renaissance.

At any rate we find him as an officer in many of the great households of the time of which records have been preserved. In the "Articles of the Order of the Householde" by Lord William Howard of Naworth Castle it is laid down that

> "The auditor being the last of all offecers, is to bee judge betwixte the lorde and his accomptants, and to deal trulie for and between all parties, and upon the determinacion of his audite, to present to his lorde by booke or breviate, all his receiptes, expences, imprestes, whatsoever, with the remaynes of monye, if any bee."

In the records of the fifth Earl of Northumberland we find that

> "my Lord will have the hoole bill of the Creditouris of the Household cast upp at Michaelmes at th' End of every yeire when the Remanith is taken and my Lord commaund to haive it doone by the Clarkis of the Kytchynge by the sight of Th' Auditours to see how th' Expenduntur for the House-

> hold for the yeire weyth with th' Assignemente [budget] of the saide yeire".

The "Auditt" was a serious affair, and in Lord Howard's household, once the auditor began to check his books, he remained in his room ". . . . the chardge and truste being so greate, so well betwixt the lorde and his accomptantes, as betwixt partie and partie. . . ." Complete physical inventories were taken of food supplies, beer and wines, silver, linen, even to the very "Wardrobe stuffs", and extra yeoman were told to assist the clerks and stewards in carrying the goods in for inspection and record. Alas! those regal days are gone; a more complex world sees Mahomet going to the mountain, and regards without astonishment a generation of auditors who climb up oil tanks to take "dips", scramble over lumber piles, and even fly planes over log booms in a relentless pursuit of physical inventory tests.

The auditors of the great estates and households were not alone in the field, and many business houses and borough councils had their accounts regularly examined. There have been preserved a number of accounts or "Audit Books" of The Worshipful Company of Pewterers of the City of London, one of the powerful guilds which have endured from medieval times to this day. The audits were conducted by members of the craft, and the Book of Ordinances of 1564 contains the following "Order for ye Audytors":

> "Also it is agreed that there shalbe foure Awdytours Chosen every yeare to awdit the Crafts accompts and they to paruse it and search it that it be perfect. And also to accompt it Correct it and allowe it So that they make an ende of the awdet thereof between Mighelmas and Christmas yearely and if defaulte be made of ffenishinge thereof before Christmas yearely every one of the said Awdytours shall paye to the Crafts boxe vi s. viii d. a pece."

The auditors "parused and searched" the accounts to some purpose, and in 1547-1548 the following items were disallowed:—

Item spent at the Ale howse by the Hall Amonge the wardens & dyvers of the company ye xxvii daye July	iii d.
Item the therde day of August spent at ye ale howse	ii d.
Item spent at an ale howse at yelde Hall when mr Curteyes prentyce was made free	iii d.

One shudders to contemplate the awful spectacle of these "Awdytours" confronted by a modern expense account.

In the accounts of 1574-1575 occur the following items consecutively:—

Item receyved, of John God, for his abuse, & greate radge had and used, to Richarde Parke, his Jorneyman at an undue howre, of the nighte	v s.
Item receyved, of the same Richarde Parke, for his contempteous usadge, in strikinge, his saide maister, & for takinge further wages, of him, then by the lawes, of this realme, he oughte, to doo	v s.
Item paid unto the Beadle, that deade is, for his quarters wages, due at Michaelmas laste	xx s.

To the same accounts were appended two qualifications. It is gratifying to find that even in those far-off days when witchcraft, ghostly visitations, and the doings of leprechauns were reckoned as serious factors in the perils of everyday exist-

ence, our professional forebears were sceptical of expenditures unsupported by vouchers, and reported as follows: —

We thinke it not reasonable, that these Accomptants be allowed that two Shillings, wch they saie, was loste by an Angell, taken of John God, & his man, by waie of ffyne . . ii s.

From their next qualification we can hear the first faint note of section 12(1)(a) of our Income Tax Act echoing down the winds of time: —

Nor, that any allowance shalbe made them, the some of xx s. wch they saie, was spent, by Thomas Hawks and Roberts Newes, in Jorneyinge to Ypswitche, unless the companie thinck of it otherwise, for the what ende, that Jorney was made, or of any proffyte that came of it, we knowe nothinge, as yet . . . . xx ti s.

At this point an acknowledgement should be made to "A History of Accounting and Accountants" edited by Richard Brown and written in 1905 for the 50th anniversary of the Edinburgh Institute, which recently came into the writer's possession. As might be expected, the authors of this book had at their disposal a rich mine of records of the historic City of Edinburgh, and many entries of interest were extracted. The present degenerate race of auditors will learn with some astonishment that their predecessors "hard" the accounts on one occasion at "vi houris in the morning". In 1576 some of the auditors refused to sign the accounts on the ground that they contained "certane soumes debursit at the convention of burrois (burgesses) to quhilk they wer nocht privye".

The Presbyterian integrity of the Scottish auditor extended even to the public disallowance of items of which he had been the beneficiary, and the auditor's report included in the "defasans" (deficiencies) of one Patryk Makmoran in the borough of Lanark in 1552-1553 "vi s. viii d. that the audyturis dranc". However, this raffish disbursement would appear to have been disallowed only because the proper authorization was not obtained; and the approved accounts for the year 1568-1569 contained the entry — "Item, xs. gevin to the audetouris in drink". One must indeed deplore the refinements of a modern civilization which no longer regards such refreshments as a proper feature of the auditor's compensation.

The fire is low; the cup is drained; heads are nodding, and we had better turn our minds to the coming busy season. Perhaps we may take away one last example of an old time audit report which surely makes its descendants seem pallid by comparison. The Worshipful Company of Carpenters was accustomed to having an "audit day" during the Court of the Company held in September. On this occasion in 1673 the auditors reported: —

"That they found many exorbitant expenses in dinners & reparacons, with divers frivolous and extravagant expenses both at home and abroad, as well upon publique meetings & courts, as in private with old masters and others, and that several sumes of money were given to the poore over and above their pencons on the qter eves & on hydaies without any order of Court whereby the stock of this Company is unnecessarily wasted & the Company run further in debt & little like-hood of getting out unlesse a speedy retrenchment be or some other remedy or redresse found out."

Inventory Valuation -- Theory and Practice

R. D. THOMAS

To FIND OUT whether accountants apply theory to practice, a survey was made of inventory valuation methods in selected Canadian businesses. The findings of this survey should be of significance to management as well as professional accountants. Operating results of individual companies within an industry have dubious comparison value if inventory valuation practices are very dissimilar.

The Survey

In selecting the companies to whom requests for information were sent, two considerations were kept in mind: the survey's scope should be national, not sectional; and inventories must form a significant part of the companies' assets. Here are the results of the survey by industry.

Public Utilities

Public utilities were divided into four types of operation: telephone, power and light, transit and gas.

Utilities of these types are not concerned with manufacturing operations, nor do they buy merchandise for sale. Their inventories mainly comprise assets used in the normal operation and maintenance of the business. American practice in public utilities[1] indicates that most companies use the average unit-price method. Nineteen of the 24 companies circularized furnished the information set out in Table 1.

[1] J. R. Foster, D. S. Rodey, "Public Utility Accounting", (New York: Prentice Hall Inc., 1951), p. 394.

TABLE 1

Valuation of Materials and Supplies of Public Utilities

	Actual	*Fifo*	*Weighted average*	*Moving average*	*Average (not stating type)*	*Did not state*	*Total*
Power	1	1	2	4	1	2	11
Telephone		1	2	1	1		5
Transit			1	1			2
Gas				1			1
	1	2	5	7	2	2	19

Textiles

Textile manufacture of cloth and clothing normally must maintain large inventories of raw materials. Many authors have stated that textile manufacturing is favourable to the use of *Lifo* for the following reasons:

1. Current material prices are reflected immediately in sales prices.
2. Large inventories of basic materials are necessary.
3. Types of raw materials are usually few.
4. Raw material prices fluctuate widely.

With the advent of so many synthetic fibres, points 3 and 4 may be less important than they have been in the past.

Only six of the 18 companies included in the survey replied and none adequately explained information submitted.

TABLE 2

Valuation of Textile Inventories

Raw material pricing		
Average (not specified)	2	
Did not state	4	6
	—	
Work-in-process and finished goods		
Standard cost	5	
Did not state	1	6
	—	
Costs reduced for seconds and substandards		
Yes	3	
Did not state	3	6
	—	
Lower of cost or market		
Yes	5	
Did not state	1	6
	—	

It is to be noted that *Lifo* was not mentioned at all even though it is theoretically desirable. This may be due to income tax considerations and the expense of valuing inventory by two different methods. In any event, because of the limited information received it cannot be concluded that *Lifo* is not being used.

In the United States a considerable number of textile companies use *Lifo*, but standard costs and the lower of cost or market are also prevalent.

Construction

The construction industry referred to here includes the building of factories, homes, etc. and also the manufacture of building products associated with construction. Nine replies were received from the 13 requests for information sent. These represented an even distribution of companies in cement, lime and gypsum production, contractors, building material and paint production.

TABLE 3

Valuation of Construction Inventories

Raw materials (excluding repair parts)		
Actual cost	1	
Weighted average cost	2	
Fifo	1	
Did not state	5	9
	—	
Spare parts for maintenance		
Actual cost	1	
Fifo	3	
Did not state	5	9
	—	
Work-in-process and finished goods		
Process costing	5	
Standard costing applies to process costing	3	
Not applicable	1	9
	—	
Lower of cost or market		
Yes	7	
Did not state	2	9
	—	

Food and Meat Processors

This category was limited to manufacturers of food and meat products

and does not include retailers of food (covered later under the general topic of merchandising). While a vast range of products is covered under this heading, most raw material of this nature is perishable, and this fact definitely affects inventory valuation procedures. In this type of operation raw materials are the most important inventory item as material is the largest component of finished product costs. Seasonal production is also an important consideration, since inventories may not be at a high or low point at the fiscal year-end.

Inventory records are generally maintained on a lot basis.

Thirteen replies were received out of 20 questionnaires sent.

TABLE 4

Valuation of Inventories of Foodstuff Companies

Raw material pricing		
Fifo	3	
Weighted average	6	
Did not state	4	13
Work-in-process		
Process costing	7	
Standard costs applied to process costing	1	
Not applicable	4	
Did not state	1	13
Lower of cost or market		
Yes	9	
Did not state	4	13

The companies using *Fifo* are in either the dairy or bakery business. Those companies using weighted average generally operated with less perishable items such as tea, coffee and confectionery. Since these products also turn over rapidly, both *Fifo* and average costing are theoretically applicable and are apparently used in practice.

Work-in-process was recorded mainly from process costing systems. This is theoretically appropriate because most products cannot be individually identified once production has begun. Those businesses where process costing was not used are engaged in either dairying or bakery production. In each of these cases the production process is not lengthy and cut-off can be made at the fiscal year-end.

Two companies mentioned that they value their finished goods at market less average gross profit and selling expenses. This procedure seems theoretically acceptable.

Iron and Steel

Because of the variations in inventories carried, this industry has been divided into three separate categories:

1. STEEL MANUFACTURERS

The base stock method of valuing inventories has been supported in the smelting industry and other converting lines on the ground that it tends to distribute earnings over operating periods in terms of the physical flow of material and thus minimizes the effect of price changes. *Lifo* adherents agree, since base stock methods are similar. *Lifo* has been stated as being used in practice[2] and the base stock method is being used in England in both the base metal and iron and steel industries.

Since steel production is a continuous process, process costing will be the most applicable. Only three replies were received from eight queries sent. However, since these in-

[2] R. M. Parkinson, "The *Lifo* Method of Inventory Valuation", *The Canadian Chartered Accountant*, Vol. 56 (May, 1950), p. 210.

cluded the three largest Canadian producers the results may be significant.

Raw materials:	
Weighted average	2
Lifo	1
Process costing	3
Lower of cost or market	3

Two companies mentioned that they credited production costs with the estimated market value of by-products

2. Rolling Stock, Machinery and Engine Manufacturers

The handling of manufacturing costs for machinery, industrial equipment, and other capital goods will vary depending upon the size and type of product, the repetitiveness of production, and quantities produced. Job order costs would seem to be more applicable than process costs. With regard to raw materials, there have been few published references to acceptable valuation bases. In the machinery industry, it is stated that *Fifo* is generally used most often when job order costing is followed.[3] The same source also states that heavy goods industries could advantageously inventory their thousands of items of spare parts by the retail method.

Replies were received from 11 out of 15 letters sent.

TABLE 5

Valuation of Inventories of Rolling Stock, Machinery, and Engine Manufacturers

Raw materials:		
Weighted average	6	
Fifo	2	
Did not state	3	11
Work-in-process		
Job order costing	4	
Standard costing	5	
Did not state	2	11
Lower of cost or market		
Yes	6	
Did not state	5	11

[3] Machinery and Allied Products Institute, "Mapi Accounting Manual", (Chicago: R. R. Donnelley & Sons Co., 1952)

Weighted average appears to be the most widely used method, while *Lifo* was not considered at all. Four companies reported that finished goods inventories are not kept because goods are produced to customers' orders.

3. Appliance and Radio Manufacturers

The chief items produced in this category are washing machines, irons, ranges, refrigerators, radios, television sets, and custom-made equipment. *Fifo* and average valuations seem to be theoretically desirable because of the large number of inventory items, rapid turnover, new products and style changes. Replies were received from eight out of 11 queries sent.

TABLE 6

Valuation of Inventories of Appliance and Radio Manufacturers

Raw materials:			
Actual cost	1		
Fifo	2		
Standard cost	4		
Not applicable	1		8
Work-in-process			
Standard costing			
Applied to process costing	4		
Applied to job order costing	1		
Applied to both methods	1		
No indication which method	1	7	
Job order costing		1	8
Lower of cost or market			
Yes	6		
Did not state	2		8

The reasons given for the large proportion of companies charging the raw materials at standard cost are:

1. Less clerical effort is required than under an average or *Fifo* system.
2. Material price variance analysis is relatively simple and often raises questions which result in cost reductions.
3. Operations are repetitive.

Merchandising Companies

Merchandising businesses can vary greatly in scope, but the most important operations can be confined to several broad categories, such as department stores, distributors and retailers of food products, and drugstores.

As would be expected, the retail method of inventory valuation is the generally recommended method for retail merchandising. Another estimating procedure that is theoretically usable is the gross profit method.

Considerable material has been written on the subject of the employment of *Lifo* with the retail inventory method.[4] This method was developed in 1941 when numerous United States retailers were concerned about inflated profits due solely to a rising price level and the retail inventory method did not remove the effects of price level changes. The United States Bureau of Internal Revenue now allows this method under certain conditions.

Of the 20 companies to which survey letters were sent, 13 replies are tabulated below.

TABLE 7

Valuation of Inventories of Merchandising Companies

Department stores			
Retail method		3	
Both retail and *Fifo* methods		2	
Did not state		1	6
Food merchandising			
Retail chains			
Fifo	2		
Retail method	1	3	
Distributors			
Fifo	1		
Did not state	1	2	5
Drug chains			
Retail method			2
			13

It can reasonably be assumed that all department stores use the retail method in most of their operations. In food merchandising, *Fifo* is being used more than retail because of rapid turnover and perishability. All replies from drugstore chains indicated that they used the retail method, however, in the wholesale distribution of drugs; cost for all items was determined by the latest invoice price. The *Lifo* modification of the retail price that has been introduced in the United States was not mentioned at all. Again, however, this was undoubtedly due to income tax considerations.

Lumber Companies

Lumber manufacturing presents unusual inventory problems on account of the variety of items handled.

In the case of the log inventory, the quantity is a matter of estimation because it is impossible to make an accurate check of the quantity of logs

[4] M. P. McNair, A. C. Hersam, "The Retail Inventory Method and *Lifo*", (New York: McGraw-Hill Book Co. Inc., 1952)

in lakes and rivers. Valuation is generally based on average cost.[5]

Quantities in lumber inventories are again usually based on estimates since accurate measurement in terms of board feet often is not made until the lumber is sold. Grading also complicates valuation procedures since various grades have different selling prices, yet production costs are relatively the same for all grades. With these complexities, three valuation methods are theoretically possible:

1. The average cost of production.[6] However, this may not show a true picture if the inventory contains a different ratio of high and low price lumber than was produced during the period.
2. Selling price less a provision for profit, selling expenses, and manufacturing costs.[7] This method assumes that each piece of lumber earns the same average profit.
3. Cost allocated to grades in the relationship of total cost to production to total selling price.[7] This method requires an elaborate accounting system. Process costing has been advocated for this type of operation,[8] and the lower of cost or market rule can be applied.[9]

Requests for information were sent to five lumber companies and four replies were received, all from companies in British Columbia. Every answer stated that a process cost system is used, and that an average cost is applied to all grades and species of product. Individual inventory costs for specific grades are not kept because all logs produce a certain amount of every grade of lumber.

The lumber industry seems to have standardized its inventory methods. The average costing procedure is used, which agrees with one of the theoretical possibilities. The other two theoretical possibilities are not used at all. Theory and practice also agree in the application of a process costing system.

Pulp and Paper Companies

The pulp and paper industry is related to the lumber industry and has many of its inventory problems. Thus it may be concluded that a theoretically desirable method would be the process cost system and the use of average costs. Generally pulp and paper are produced either in the same plant or in the same company, so both processes will be treated together.

Eleven pulp and paper companies were asked for information and eight replies were received. (See table 8 at top of next page.)

Raw materials are generally charged into production at an average price. The officials of the company which uses *Lifo* reason that they do not want to be left with a high-priced inventory in the event of a decline in the cost of materials. One

[5] K. O. Roos, "Some Accounting Problems in the Lumber Manufacturing Industry", *The Canadian Chartered Accountant,* Vol. 54 (April, 1949), p. 177.

[6] J. K. Lasser, Editor, "Handbook of Accounting Methods", 2nd ed. (Toronto: D. Van Nostrand Co. (Can.), Ltd., 1954), p. 693.

[7] Loc. cit.

[8] H. W. Eckardt, "Accounting in the Lumber Industry", (New York & London: Harper and Bros. Publishers, 1929) p. 13.

[9] W. Mucklow, "Lumber Accounts", (New York: American Institute Publishing Co., Inc., 1936), p. 55.

TABLE 8

Valuation of Inventories of Pulp and Paper Companies

	Fifo	*Lifo*	*Average*	*Process costing*	*Standard costing*	*Did not state*	*Total*
Raw materials	1	1	5			1	8
Supplies			4			4	8
Work-in-process				5	1	2	8
Finished goods				5	1	2	8

company that uses average cost stated that pulp-wood was charged into production at an average of the highest costs paid during the year. If costs were rising this had the effect of charging on a last-in-first-out basis; if a falling market, on a first-in-first-out basis. At the year-end, pulpwood cost was determined at the average laid down cost for the year.

Valuation of supplies seems to be relatively standardized, as far as was reported. Goods in process and finished goods are predominantly valued by a process costing system.

Mining Companies

In order to obtain a good cross section of current mining practice, most major types of mining operations (copper, lead, zinc, gold, asbestos, nickel, iron and uranium) were included in the survey. Of course, inventories will vary somewhat within these classifications but essentially all operations require supplies and maintenance materials, such as explosives, timber, pipe and maintenance parts. Those companies engaged in smelting operations will also be concerned with semi-processed and finished goods.

A prominent authority[10] has stated: that, for the mining industry in Canada, the following are good accounting practices:

1. In pricing withdrawals from stores, average costs should be used for inventory purposes. This will eliminate the possibility of prices lagging behind rises and falls of purchase prices and magnifying their effect.
2. Mine accounting must determine costs for two basic operations:
   a. The cost per foot of developmental work such as diamond drilling, shaft sinking, and cross cutting. This is generally accomplished by a job cost system.
   b. Production costs in terms of tons of ore mined; this is accomplished by a process cost system.

In smelting operations, it is not practical to record quantities produced by each department since solids are rapidly converted into liquids and back again. Quantities are usually recorded accurately only when the ore is crushed in the first milling operation and after it becomes a finished product. Inventories of ore in process are scarcely ever established in the accounting records.

Finished goods inventories of base metal operations are usually valued at current market prices or future prices stated in sales contracts already made, allowance being made in handling and shipping charges. Some base metal companies, however, value

[10] Willcox, F., "Mine Accounting and Financial Administration", Toronto: Sir Isaac Pitman & Sons (Canada) Ltd., 1949.

their inventories on the basis of production costs.

Mention has already been made of the theoretical advantages of *Lifo* in the smelting and refining of nonferrous metals. This is another example of a situation where costs and selling prices are directly related. American practice has indicated that *Lifo* has been adopted to a considerable degree in these cases.[11]

A total of 30 mining companies were sent requests for information and 16 replies were received. The valuation practices for raw materials and supplies can be summarized as follows:

Average costing—			
Weighted Average	5		
No type specified	6	11	
Fifo		2	
Did not state		3	16
		—	=

This indicates that average costing is by far the most generally used method and, accordingly, theory is being carried out in practice.

Many companies did not mention process or finished goods inventories. However, this does not eliminate the necessity of process costing, which was mentioned by all companies reporting work in process inventories. Most finished goods are sold on a forward or contract basis and are immediately disposed of upon completion. Consequently only six companies reported significant inventories of finished goods. Three reported inventories at estimated selling price less delivery and insurance costs and three valued the inventory at cost of production. There seems to be no set rule regarding which procedure is used, but market value seems to be more widely used when the following conditions are present:

1. A steady demand for the product.
2. A fixed selling price is assured, such as the mint value of gold.
3. Where sales contracts have been finalized for the output.

Oil Companies

Many companies operate entirely in the exploration and drilling field. Joint ventures are often formed for the exploration phase, with a provision that when properties are proved productive, the facilities will revert back to the original owner. Therefore, inventories of exploration companies will be transferred to many jobs through their lifetime and some valuation is necessary to charge each job. *Lifo* has often been advocated for the petroleum industry and could be adopted in these circumstances.

In the refining field, inventories become more complex for two reasons. Firstly, it is impossible to trace each barrel of oil and actually cost it as it progresses through the refinery. Secondly, the main function of refining is simply the breaking down of crude oil into light, intermediate and heavy products by a distillation process. Consequently, there is a variety of finished products, the basic processing cost of which is identical. Therefore, some estimated costing procedure is theoretically necessary. There are three methods that could be used:[12]

1. The relative sales value method, where production costs are al-

[11] C. G. Blough, Editor, "Use of *Lifo* by Industry Groups", *The Journal of Accountancy*, Vol. 86 (July 1948), p. 68-69.

[12] American Petroleum Institute, "Outline of Petroleum Industry Accounting", (Baltimore: The Lord Baltimore Press, 1954), p. 144.

located to products on the basis of their sales value.

2. The by-product method, in which the market value of all by-products are deducted from the total production costs, and the remainder is considered to be the cost of the main product, generally gasoline.
3. The replacement cost method, in which gasoline is the main product, fuel oil the only by-product, and other products are regarded as joint products.

Inventories of finished stocks are also sometimes valued at selling price less the estimated costs of shipping and delivery. There are four chief reasons for this:

1. Difficulties are sometimes encountered in finding dependable cost figures.
2. The industry is primarily concerned with technical production rather than selling.
3. There is usually an active market for the output, therefore assuring a sale at the current price.
4. It is claimed that income is effectively earned through the production process and should be accrued on the product on hand awaiting delivery.

Lifo has often been associated with the oil industry, primarily because raw material costs influence finished product prices. In 1934 the American Petroleum Institute advocated *Lifo* and since that time it has become an acceptable method for tax purposes in the United States. Average costs, *Fifo* and base stock methods have also been mentioned in connection with this type of operation.

Seventeen oil companies were included in the survey and ten replies were received, evenly divided between drilling and refining operations. The results from exploration and drilling companies are summarized below.

TABLE 9

Inventory Valuation of Oil Companies In the Exploration and Drilling Field

Materials and supplies other than tubular goods		
Fifo	1	
Weighted average	3	
Did not state	1	5
	—	
Lower of cost or market		
Yes	4	
Did not state	1	5
	—	

Materials and supplies other than tubular goods actually comprise a small portion of inventory. Casings and tubular goods may comprise 90% of the inventory value, and are segregated because they are treated in a different manner. This manner is described in an accounting bulletin for unit and joint lease operations, published in 1953 by the Petroleum Accountants Society of Western Canada. Under this procedure, material is charged to the job on the basis of current replacement cost. Once material is used, it may become damaged to the extent that it is not as valuable for the next job and the value is adjusted downward accordingly.

On the refining and distribution side of oil production the results of the survey are summarized in Table 10.

TABLE 10

Inventory Valuation of Oil Companies in the Refining and Distribution Field

Raw materials		
Weighted average	3	
Lifo	1	
Did not state	1	5
	—	

Finished goods		
Sales realization method	3	
Not applicable	1	
Did not state	1	5

Lifo is being used by a company incorporated in Canada which is not subject to Canadian income tax because its operations are entirely outside Canada. This might indicate that if the government lifted its ban on *Lifo*, many oil companies would make a change. In the case of process and finished goods, the only procedure stated was the sales realization method. This method has been approved by the American Petroleum Institute.

Conclusion

The survey indicates that although a close relationship exists between theory and practice there is some diversity in the methods being used by companies in the same line of business.

SEATING AND HEALTH

In an address to the 21st anniversary meeting of the Association of Industrial Medical Officers in London, the Earl of Verulam referred to the importance of correct seating for sedentary workers. He said there should be new research and a fresh approach to the seating problem. Correct support of the lumbar region and proper placement of the ischial tuberosities [bony prominences which support the body in a sitting position] might do more to increase production and enhance health than all the panaceas beloved of the merchants of productivity.

—*Taxes,* October 1956

Statistical Theory in Test Checking

E. L. PURSEY

THE USE OF statistical methods in test checking is a recent development of the auditing technique. It represents an extension to auditing of methods of product inspection based on sampling, which have been adopted increasingly by industrial concerns over the past 25 years.

Faced with the suggested use of statistical methods, auditors may fear that it is proposed to replace judgment and experience by a series of formulae. This is not so, although the auditor's judgment may have to be expressed in more explicit terms than is usually the case at present.

Statistical methods are not at present a generally accepted procedure in test checking, except for certain specialized applications; but the attempt to relate the theory of statistical sampling to testing practice is of value. It requires a fresh examination of the purpose and basis of accepted procedures.

Theory of Test Checking

Test checking is based on a theory that the attributes of a representative sample, selected from a large series of homogeneous transactions, will be very similar to the attributes of the whole series. Thus, if test checking reveals a low proportion of errors in the sample, it may be assumed that the proportion of errors in the whole is also low. It is recognized that any examination based on test checking involves a risk that the sample selected for testing does not reflect truly the attributes of the whole group. This risk is accepted, if seldom measured.

The factors involved in this theory may be stated in a form more readily correlated with statistical sampling requirements. It will be assumed that the purpose of the test is to confirm or deny that the proportion of errors in a series of transactions is acceptably low. An auditor is then faced with the following considerations:

(a) What constitutes the group of transactions or other data from which the sample will be selected for testing, and to which the results of the test will be considered to apply? (Hereinafter referred to as the "field".)

(b) What is the maximum proportion of errors in the field which is acceptable to the auditor? (Hereinafter called the "acceptable error limit".)

(c) What minimum assurance (i.e., probability) is required by the

auditor that a field containing errors in excess of the acceptable error limit will be disclosed as such as a result of the test? (Hereinafter referred to as the required "degree of assurance".)

(d) What is the appropriate sample size?

An Example

A test might be made from a series of 5,000 sales transactions to confirm that prices are being entered properly on the sales invoices from the company's approved price lists. The auditor decides that, in the circumstances, a rate of error in entering prices not exceeding on the average 1 in 100 will be acceptable. He wants an assurance that rate of error greater than 1 in 100 will be disclosed by his test in at least 90% of the cases. In this example, the field consists of 5,000 prices entered on sales invoices, the acceptable error limit is 1% and the required degree of assurance is 90%.

The field, the acceptable error limit, the degree of assurance and the sample size enter into every examination which is based on testing. Inherent in the idea of testing, of course, is that the auditor must accept some errors in the field and be content with something less than complete assurance that his test will reflect the true quality of the field.

Under current auditing practice, the sample size is determined by the auditor through the application of his judgment and experience to the circumstances of the case. The acceptable error limit and degree of assurance are kept in mind, but have no specific values attached to them. It is agreed, however, that there is a relationship between these two factors and the sample size, and hence the amount of testing is increased when a higher assurance is required or fewer errors are acceptable in the field. Nevertheless, there is frequently some doubt whether an adequate size of sample has been selected for testing.

The introduction of statistical sampling theory into test checking is primarily an attempt to express the relationship between the field, acceptable error limit and required degree of assurance in mathematical terms, so that the auditor may have some guidance in determining the size of his sample and the number of errors permissible. Use of the theory, however, can only supplement, never supersede, the auditor's judgment. It is based on the probabilities of finding any specified proportion of white balls in a sample drawn at random out of a drum containing known proportions of white and red balls. This assumes each ball to be in every way comparable with the others, which usually cannot be the case with accounting transactions. Also, statistical methods take into account only the number of errors found in a sample, and not their individual significance — each item must be classified as either "right" or "wrong". These difficulties can be reduced and controlled through the design of a sampling scheme, but cannot be completely eliminated.

Statistical methods are suitable for auditing use only under certain conditions which are discussed briefly later. These methods are applied in practice through the use of charts or tables indicating, for a given approximate size of field, the sample sizes and number of permissible errors in the sample which will satisfy the auditor's requirements as to acceptable error limit and degree of assurance. Al-

ternatively, given a known sample size and the number of errors found in the sample, the charts or tables indicate what acceptable error limit and degree of assurance have been attained. For a predetermined acceptable error limit and degree of assurance there are a large number of suitable sample sizes, depending on the number of errors permissible. For a given sample with a known number of errors, there are various combinations of acceptable error limit and degree of assurance available; as the acceptable error limit is reduced, the attained degree of assurance will also be reduced, although not in proportion.

The Field

The items making up the field, i.e. group of transactions (accounts, invoices, etc.) from which the sample will be drawn, should be of an essentially similar nature and comparable as regards the attributes to be measured. Each item should be small in relation to the field as a whole, so that individual errors will have no significant effect on the overall quality. One example meeting these conditions is a check on whether the gross pay shown on payroll entries is calculated from hours worked and rate. If these requirements are not fulfilled, it is unlikely that the field is suitable for examination by statistical sampling methods.

Each item in the field must have its equal chance of being included in the sample drawn for examination. Conclusions arrived at as a result of the examination of the sample can be applied only to the field, that is, those items out of which the sample was drawn. This requirement appears logical, but seems to be at variance with accepted testing procedures in the field of auditing. For instance, a conclusion on the state of a company's accounts receivable arrived at through tests could not be supported by statistical theory if the tests were restricted to certain ledgers or certain locations, as might occur in the audit of an organization with many small accounts receivable maintained at a number of separate locations. Similarly, tests restricted to one month of the year could not be used directly to support a conclusion on the accounts for the whole year.

Acceptable Error Limit

The proportion of errors which is permissible in the field must be decided by the auditor. As statistical methods take into account directly only the number of errors, and not their individual significance, it is important to define what will constitute an error for the purpose of any specific test. If the test is to confirm adherence to predetermined accounting procedures, each irregularity in procedure may be classed as an error, with no particular importance being attached to the dollar value of mistakes. On the other hand, if a test is intended to confirm proper inventory pricing, numerous small differences may be expected and only major differences will be classified as errors.

Errors found during testing may sometimes appear to indicate a trend in one direction. If statistical methods are used, there is a formula to indicate whether the trend in the sample is incompatible with random occurrence of errors in the field.

Where the field consists of transactions or other data of varying dollar value, it is possible to subdivide it into several strata based on value. A

separate sampling scheme may then be applied to each section, with probably a more exacting requirement as regards degree of assurance applied to the high value sections of the field. This procedure (called stratification) can offset to some extent the disadvantage of statistical methods in attaching equal significance to all errors found in a test.

Degree of Assurance

Like the acceptable error limit, the degree of assurance required must be decided by the auditor. Using statistical sampling methods, the degree of assurance represents the probability of rejecting a field which contains a proportion of errors equivalent to the acceptable error limit. In most auditing applications there will not be a rigid level of errors beyond which the field must be almost certainly rejected, but below which there must be high assurance of acceptance. More likely, the acceptable error limit will be an approximation subject to reasonable amendment as the examination of the sample progresses and the auditor is better able to assess the circumstances. If the acceptable error limit is set fairly low, it will not be necessary to specify an unduly high degree of assurance — 90% should be ample. If the actual proportion of errors in the field is twice the stated acceptable error limit, the probability of rejection of the field will then be almost 100%. Rejection means, in effect, that a more extensive examination of the field is necessary.

The Sample Size

Using statistical methods, the sample size will depend on the following:

(a) Size of the field.

(b) Acceptable error limit.

(c) Degree of assurance.

(d) Number of errors to be permitted in the sample without rejection of the field.

In practice the required sample size will be obtained through the use of tables or charts. Generally speaking, it will increase only slightly with an increase in the size of the field (hardly at all when the field is large); will double if the acceptable error limit is halved; and will increase, but not in proportion, as the degree of assurance or the number of permitted errors in the sample is increased.

Of greatest interest to auditors is the fact that the required sample size increases only very slightly with an increase in the size of the field. The sample size to form an opinion on a field of 100,000 transactions will be little greater than that for a field of 10,000 transactions. Similarly, a decrease in the size of the field has little effect on the size of the sample. The underlying theory may be illustrated by imagining a large drum containing 10% white and 90% red balls. As a test sample is drawn from the drum, the chance of each ball drawn being white is 10%, regardless of the total number of balls involved. As the number of balls drawn as a sample is is increased, the more likely is the sample to approximate to 10% white and 90% red, again regardless of the total number of balls in the drum.

By statistical methods, therefore, the minimum sample size (allowing no errors to be found in the sample) depends almost entirely on the acceptable error limit and the required degree of assurance. This contrasts with general audit practice, where samples drawn for testing are frequently a specified proportion of the field, such as 10%.

The minimum sample sizes in-

dicated by application of statistical theory tend to be much larger than sample sizes frequently used by auditors. Assuming requirements of 1% acceptable error limit and 90% degree of assurance, the minimum sample size (allowing no errors to be found in the sample) would be approximately 250 items. If one error was allowed in the test sample, the sample size would be increased to about 400. Most auditors would likely want a 90% probability that the rate of error in a given accounting operation did not exceed 1%, and almost 100% assurance that the rate was not in excess of 2%. If so, assuming statistical theory to be applicable to auditing, it would be difficult to justify selecting samples of 50 or 100 items for testing. If no errors are found in a sample of 50 items, the probability that the field contains 1% errors is 61%, and that it contains 2% errors is 37%. Perhaps a test should consist either of the full sample indicated by statistical theory (say 250 or more), or else of only two items – the first to indicate what regular accounting procedures are in force for this particular type of transaction, and the second to confirm that the first is not an exception.

The application of statistical methods to test checking is economical where very large fields are involved, such as in public utilities or large department stores. On the other hand, the large minimum sample sizes would become uneconomical on many audit engagements. It is claimed, however, that for a given degree of assurance statistical methods are the most economical; when smaller sample sizes are selected, as is the case frequently in auditing, an adequate degree of assurance is not in fact attained.

Methods of Selecting the Sample

The sample to be examined must be drawn from the field on a random basis. This means drawing each item using published random sampling tables or by other means of systematic selection on a statistically random basis. The use of these methods is likely to require a greater expenditure of time than is usually the case in audit testing. Nevertheless, statisticians feel strongly that valid conclusions cannot be based on samples which have been selected by the usual audit methods.

Under accepted audit practice, selection is frequently based on judgment and convenience, and is very rarely carried out by methods which would qualify as statistically random.

Comparison With Accepted Audit Procedures

The three most important points in which statistical sampling techniques are at variance with presently accepted audit procedures are:

(1) Statistical methods require that the sample should be drawn from the whole field to which the conclusions deduced from the sample are to be applied. It would therefore be unsatisfactory from the statistical viewpoint to restrict tests to only a part of the year or to only a portion of the relevant records.

(2) Statistical theory gives little weight to an increase or reduction in the size of the field in calculating the necessary size of sample. With a relatively small field, such as might be found in many small and medium-sized examinations, the minimum size of sample indicated by statistical theory is substantially greater

than that commonly used by auditors.

(3) Statistical methods require that the sample be selected from the field on a mathematically random basis, without interference of human judgment or convenience.

It must be stated that presently accepted audit procedures in testing, although apparently deficient in some respects from the viewpoint of statistical theory, appear to have been applied successfully in practice. Perhaps statistical sampling theory is not fully applicable to auditing. On the other hand, audit procedures in test checking may be partly unsound, with their deficiencies mitigated by additional work carried out by the auditor. Certainly, testing of detail transactions is only one of the steps taken by an auditor before he forms his opinion on the state of a company's accounts and records.

It should be noted that when statistical sampling methods are used, definite values are set on the acceptable error limit and the degree of assurance. Although this is probably an advantage, it places the auditor in a position where the values he puts on these factors are specified, and therefore subject to challenge. It may be said for the statistical method that it is only placing a definite value on a risk which already exists.

Statistical Methods in Auditing

Clearly, statistical sampling is most suitable, efficient and economical where the volume of transactions is large, such as in sales invoicing, payrolls, stores records, and some types of accounts receivable.

It is important to review carefully the errors found in the sample to determine whether they are routine clerical inaccuracies or whether they indicate serious irregularities in the records. The statistical method deals only with the number of errors found in the test, and it remains for the auditor to consider their possible significance.

To sum up, the general adoption of statistical methods for test checking would involve several practical difficulties. However, an examination of these methods must lead to possible avenues of improvement in current test checking practices. If there is justification for employing them where they show to best advantage, without necessarily requiring their use generally, it will be possible to improve both the efficiency and economy of a large portion of audit work.

Capital Gains

STUART D. THOM

THE FIRST impression as to the practical situation with regard to capital gains on the Canadian scene is one of confusion and uncertainty in the public mind. This unfortunate state of affairs is the outcome of a number of factors, some at least of which are temporary and subject to correction. In the first place there is an inevitable borderline situation latent in any tax system which does not bulk all receipts under a common heading and apply one tax to the whole amount.

Another factor of the problem in Canada is that our courts not only purport to follow but in fact pretty well do follow the law as it was developed in Great Britain. In the 1920's there may have been considerable public feeling against the generally successful efforts of the revenue in that country to expand the significance of income for tax purposes. For its own reasons, good or otherwise, the tax administration in Canada appears to have made little effort in the years before the last war to apply the principles of law that had been developed in the mother country. Prior to the decision in 1948 by Mr. Justice Thorson in the case of *Atlantic Sugar Refineries Limited* there had been but one other case in which the principles relevant to the distinction between taxable and non-taxable income were discussed, and that was the *Morrison* case in 1927. It may be that during all those years Canadian taxpayers were being assessed for tax and willingly paying tax that in Great Britain was a source of constant litigation, but it is not likely. Rather, during those years government inertia allowed a conception of tax-free gains to become established in the public mind in this country that was not warranted by the law. If today that conception is being reduced to its proper dimensions to the accompaniment of considerable complaining from some quarters it does not follow that non-taxable capital gains are vanishing but that certain gains having the quality of income but hitherto ignored are now being taxed.

A further contributing factor to our Canadian problem is the unpredictable but none the less real impact of the United States rules and practice in the mind of the Canadian taxpayer. It is, for instance, generally believed that there is a greater degree of certainty regarding the tax

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cost of a transaction in the United States than is the case here. Actually that is probably so. Where all gains are income and categorized only for the purpose of determining the rate of tax it is feasible to go quite a distance in the way of laying down statutory rules to separate the categories. Part of the price we pay in Canada for the complete tax exemption afforded some gains and receipts is the greater freedom of the courts to decide the borderline or no-man's land case. Moreover, if it comes to the matter of devising statutory rules or tests to separate taxable from non-taxable gains the final revision will be undertaken by the tax collector.

Uncertainty in the Tax Law

The quality of certainty in a tax law is nevertheless of the utmost importance in the operation of any tax scheme, and there is an unnecessary deficiency of that desirable element in the Canadian income tax picture today. A pretty good case can be made against the administration on this score. One would like to assume that underlying the aggressive post-war policy to redefine income heralded by the *Atlantic Sugar* case in 1948 and the *McDonough* case in 1949 there was a coherent purpose and plan. Almost all indications are to the contrary. Speculative real estate profits have been pursued relentlessly accompanied by a policy of assessing back into years before there was any indication of the new policy. Speculative stock market profits, however, are still largely untouched. Gains resulting from bonuses and discounts involved in the lending of money have been assessed, but resulting litigation has not gone beyond the Tax Appeal Board level.

The outsider's knowledge of government policy is necessarily sketchy and probably inaccurate where, as in the case of capital gains, we have to rely on the trend of the cases supplemented by such other odds and ends of information as can be picked up. There is, however, every indication that government policy has undergone a change in recent years. Unless the nature and significance of the new approach is made clear to the public, people naturally go about their affairs on the basis of what the law is commonly known to be from past experience. It is the disparity between the law that is motivating government policy today and public awareness of it that generates the feeling that the government is up to some tricks and that in a devious and secret way we are about to be deprived of the tax-free enjoyment of capital gains. We must do the best we can, however, to grasp the present state of the law.

Recent Statutory Amendments

Turning first to the statute law, in recent years the government has acted through statutory provisions and supporting regulations to bring under tax amounts that formerly were tax-free. The instance that immediately comes to mind is that of the recapture of depreciation, by which part at least of an amount that is non-taxable gain on any basis of principle is now taxed. The government's justification probably is that the allowance for depreciation is on account of capital and the taxpayer cannot expect to enjoy the deduction of a capital amount from income without suffering some compensating addition of a capital amount to his income on the same account.

Reference should also be made to section 83 exempting prospectors'

profits from taxation. The immediate interest this section has is that the administration treats it as defining the limits of tax-free gains in this particular field of activity. That is to say, a gain that does not qualify for statutory exemption is regarded automatically as taxable within the intent of the statute no matter what the particular facts of the case may be. Proponents of a statutory definition of income or of capital gain at large might bear in mind that it would become a fence between the two, and beyond doubt any disputed territory would end up on the income side.

Present State of Case Law

Turning now to case law, the first question that comes to mind is to ask why the law of Canada recognizes the distinction between income and capital gains at all. This is not a foolish or unnecessary question but is asked because the answer has some present day significance.

As more than one writer has already pointed out, the language of the Canadian Income War Tax Act is quite similar to the language originally used in the United States statute and has no resemblance to the language of the British Income Tax Act at all. One is almost forced to believe that the draftsmen of our Act had the United States Act in mind. By 1917 the all-embracing concept of income that characterizes the United States income tax scheme was well to the fore in that country, even though it had not been conclusively affirmed by Supreme Court judgments. One is tempted to ask whether similarity in statutory language was intended to be the prelude to parallel conceptions of the meaning of income. The question is not discussed in any of the cases. In *Anderson Logging Company Limited* v. *The King*, which arose as a result of a 1922 assessment under a British Columbia statute that defined income in exactly the same terms as section 3 of the Dominion Act, the issue presented for the determination of the courts was whether a profit made on the sale of certain timber limits was income or capital as those terms were understood in Great Britain. The judicial discussion revolved entirely around the British cases and the assumption must be that the Province made no effort to tax the company on the basis of the United States concept of income that was by then clearly defined. Nor will there be found in any case that has arisen under the Dominion Act the slightest suggestion that income might be something other than what was recognized as such in Great Britain. Our economic development has many more points of resemblance with that of the United States than of Britain and one might have expected that the economic consequence as evidenced in the field of taxation would have been to follow the United States practice. The weight of United States precedence had, however, no influence against the attitude of mind in this country which might be characterized as legal and political colonialism.

The point of this is that with the exception of statutory interventions the Canadian government has not taken independent action toward the moulding of a Canadian type of tax. It was not by mere inadvertence that lawyers and the courts were allowed to take over the interpretation of the Act from 1917 on. Rather, it was the application of a deliberate policy of deferring to the British precedent that governed the action of the Department of National Revenue in the

enforcement of its new law and that attitude has prevailed by and large to the present time.

Badges of Trade

To revert to the theme of this discussion all that the tax administration appears to be doing today is attempting to bring the judicial concept of income in this country into line with developments in Great Britain since 1920. If there is justification for this opinion, then there is reason for directing attention to the latest and most authoritative statement with regard to the judge-made law in the United Kingdom. The Royal Commission Report had this to say:

> ". . . we have noticed that there has been some lack of uniformity in the treatment of different cases according to the tribunals before which they have been brought. This seems to us unfortunate and, for the sake of clarity, we have drawn up and set out below a summary of what we regard as the major relevant considerations that bear upon the identification of these 'badges of trade'.
>
> (1) *The subject matter of the realization.* While almost any form of property can be acquired to be dealt in, those forms of property, such as commodities or manufactured articles, which are normally the subject of trading are only very exceptionally the subject of investment. Again property which does not yield to its owner an income or personal enjoyment merely by virtue of its ownership is more likely to have been acquired with the object of a deal than property that does.
>
> (2) *The length of the period of ownership.* Generally speaking, property meant to be dealt in is realized within a short time after acquisition. But there are many exceptions from this as a universal rule.
>
> (3) *The frequency or number of similar transactions by the same person.* If realizations of the same sort of property occur in succession over a period of years or there are several such realizations at about the same date a presumption arises that there has been dealing in respect of each.
>
> (4) *Supplementary work on or in connection with the property realized.* If the property is worked up in any way during the ownership so as to bring it into a more marketable condition; or if any special exertions are made to find or attract purchasers, such as the opening of an office or large-scale advertising, there is some evidence of dealing. For when there is an organized effort to obtain profit there is a source of taxable income. But if nothing at all is done, the suggestion tends the other way.
>
> (5) *The circumstances that were responsible for the realization.* There may be some explanation, such as a sudden emergency or opportunity calling for ready money, that negatives the idea that any plan of dealing prompted the original purchase.
>
> (6) *Motive.* There are cases in which the purpose of the transaction of purchase and sale is clearly discernible. Motive is never irrelevant in any of these cases. What is desirable is that it should be realized clearly that it can be inferred from surrounding circumstances in the absence of direct evidence of the seller's intentions

and even, if necessary, in the face of his own evidence."

These tests or indicia of a trade and hence of taxable income are not presented as a statement of what the law necessarily is at the present time but rather of how the law may be expected to develop under the impact of taxpayer and tax collector arguments on the judicial mind. The usefulness to us of these indications or badges or trade rest on the premise that today's law in the United Kingdom will be tomorrow's law in this country. They also give clear expression to the opinion of very well qualified people that the borderline case between taxable and non-taxable gains cannot satisfactorily be dealt with by a formula or definition of what is income or what is capital gain. In any particular case the answer will represent a balance between a number of considerations depending upon the facts of the case.

The experiences of the ordinary business taxpayer have not been discouraging by any means. The Supreme Court in the *Sutton Lumber* case has held that the sale of a timber limit originally acquired to be cut over in the course of the company's business and later sold when this was not feasible did not give rise to a profit. In the Exchequer Court the appeal of British and American Motors (Toronto) Limited has recognized the distinction between assets of a company acquired for resale and those acquired to be held and used as plant. These cases, both of which were developed out of the case law of Great Britain, recognize and give effect to the distinction between capital assets and inventory that is substantially the same as the statutory rule to be found in section 1231 of the United States Internal Revenue Code.

There can be found in the case law of Canada, Great Britain and other Commonwealth countries principles and precedents which, when taken together, serve reasonably well to distinguish a capital gain from an income profit. The Department of National Revenue is today drawing on that body of law to bring profits under tax that hitherto escaped charge not because they were capital in the eyes of the law but because the law had not been applied. Standing outside the field of taxable gains are gifts and inheritances, prizes, sweep stakes, jack pots and the like, gambling winnings where gambling is not a source of livelihood and realized and unrealized appreciation in the value of investments, plant or assets held for capital purposes. It is a fairly extensive field.

How "Certain" Should the Law Be?

These remarks cannot be brought to an end without some discussion as to whether there should be a change in the law. Mention has already been made that there should be some statutory definition that would allow a taxpayer to recognize the quality of the gain which he is contemplating with some certainty. The common characteristic of those who take this position is that someone else should draft the definition. So far no efforts in that direction have been put forward for serious public discussion. This leads one to think that the task is well nigh impossible and that although statutory sign posts, so to speak, may be useful the point is reached sooner or later when the issue must be settled on the basis of the rather extensive and loosely organized series of tests that have al-

ready been referred to. A further characteristic of the comments of those who advocate a statutory definition is that the definition is to serve as a defence to taxpayers against further expansion of the field of taxable income. This attitude is unrealistic to a high degree. Under pressure the government will exempt specific gains or give them special treatment, but nothing in the history of our tax development over the past decade lends encouragement to the hope that government will deliberately set general limits on its taxing power.

One should not, however, rule out the possibility of statutory intervention. The policy-makers in Ottawa are surely aware of public feeling and it could be that the government even now is engaged in devising legislation that will be presented nominally as an answer to the clamour for certainty in the law but will at the same time extend and secure the Revenue's claim on certain types of income that at present escape taxation. There are no public indications of a move in that direction but persistent complaints might provide the excuse for moving into a field of income that has hitherto been free of the tax collector.

Vulnerability of Stock Market Transactions

It seems to be clear enough that a basic purpose of Canadian tax policy is to make this country attractive to capital. It seems fair to say that an inducement held out to the owners of capital is to permit them to benefit to the fullest extent in return for the risks involved in any capital undertaking. The foreign or Canadian investor who puts his capital to work in industry or in the development of one of our natural resources need have no fear presently or for some time in the future that the capital growth of such an investment will be taxed. On the other hand, the so-called investor who uses his capital to acquire property with a view to resulting gain on a later sale may be, but not necessarily will be, taxed.

More frequently than not, a stock market transaction or security purchase has a conspicuous trading flavour about it. The profit taker, however, escapes taxation apparently because the government is influenced by practical administrative reasons and chooses to disregard the resulting inequities between classes of investors.

One probable reason or excuse is the sheer labour of policing the stock market and security trading activities of the Canadian tax-paying public for the purpose of separating the investor from the speculator. A possibly more compelling reason may simply be that the game is not regarded as being worth the candle. Losses as well as gains are a notable feature of stock market and security transactions, and the government is well aware that any practice by which gains would be taxed would have to make some allowance for the losses.

Another practical reason for not taxing capital gains is the complications that are involved. In order that such a tax may be computed it is necessary to establish a basis of value for every item of property to which the proceeds of realization can be related. In the United States this concept of "basis" enters into every conceivable commercial transaction. It has become the subject of intensive refinement; it is a fruitful source of dispute and complicates the law in a

most substantial manner. It is possible to believe that those responsible for Canadian tax policy are by no means convinced that the amount of revenue that would be brought in would balance the complications that will be inevitable in the administration of the law.

The foregoing remarks on the *pros* and *cons* of a capital gains tax have been concerned with various considerations of a practical nature that do not get to the heart of the question of whether an income tax that does not cover all manner of gains is fair and equitable. All gains that are the result of an expenditure of effort or of capital or both have more factors in common than they have points of difference. The English income tax, however, was not devised to levy a tax equitably among all the inhabitants of the country by reference to their control over economic resources or however you wish to express the purpose of an ideal income tax. The tax was levied on certain specific benefits and gains and the gains were identified by their sources, for example: land, investments, trade, employment, etc. When in the fullness of time Canada took on an income tax we followed the British lead.

There is no doubt that our tax system functions in such a way that some are able to keep gains that in strict logic and equity should be taxed. The legislative history of our Act indicates a constant process of tightening up the tax net where weaknesses from the revenue point of view show themselves. It can be assumed that this process will continue. It is highly doubtful from the overall point of view of taxpayers that they will gain anything by accelerating the process.

A 1,000 TICKET CLAIM

A paper bag bulging with bus tickets has been sent to the Inland Revenue by Michael Ward, film and TV actor. This is in support of his claim for income tax relief for expenses. Mr. Ward, in an interview with *Reynolds News,* said:

> "I have been saving every bus ticket for over a year. Nobody appreciates how much an actor has to spend on journeys – as part of his job. This is the only way I can show the income tax people how much I *do* spend."

The bus journeys include trips to the hairdresser and the dentist. Said Mr. Ward: "It's not that actors are conceited, but we're obliged to spend more than most people on keeping a good appearance."

– *Taxation,* October 20, 1956

BY GERTRUDE MULCAHY B.A., C.A

Accounting Research

The C.I.C.A. Research Department

ACCEPTANCE OF RECENT RESEARCH BULLETINS — CONT'D

The suggestions of Bulletins No. 9 and 11 are designed to correct inconsistencies and misunderstandings existing in certain areas of financial reporting. In contrast, the recommendations of Bulletins Nos. 10 and 12 present solutions to specific problems arising as a result of changes in economic conditions. In both of these latter submissions, the committee has directed attention to problems of income measurement created by Canadian tax law. In one case, (Bulletin No. 10), a change in the regulations was the immediate cause of action, whereas in the other, (Bulletin No. 12), a change in the significance of an existing provision resulting from the increased importance now attached to the figure for net profit for the year in annual reports called for a recommendation.

Both Bulletins Nos. 10 and 12 suggest procedures for fair presentation in circumstances where the computation of net profit is complicated by the existence of a problem of income tax allocation.

"The problem of allocation of income taxes arises in those cases where there are material and extraordinary differences between the taxable income upon which such income taxes are computed and the income for the period determined in accordance with generally accepted accounting principles."[1]

The circumstances subject to recommendations in Bulletin No. 10 reflect differences arising as a result of the claiming of capital cost allowances for tax purposes in excess of the depreciation recorded in the accounts. Bulletin No. 12 deals with differences resulting from the application of the loss-carry-over provisions of the Canadian Income Tax Act.

Bulletin No. 10 — Depreciation, Capital Cost Allowances and Income Taxes

The first two paragraphs of Bulletin No. 10 clearly outline the basic problem considered in this submission:

1. Income Tax Regulation 1100(4) limited claims of corporate taxpayers for capital cost allowances to the amount of depreciation recorded in the accounts. The recent repeal of this regulation has eliminated management's dilemma of either charging an excessive amount as depreciation, in order to be in a position to claim maximum capital cost allowances for tax purposes, or making only an appropriate depreciation charge and so paying greater current taxes than necessary. At the same time this extension of the right to claim capital cost allowances without regard to the amount of depreciation charged in the accounts presents a serious problem of income measurement where substantial tax reductions result from allowances which are not reflected as deductions in cal-

[1] "Accounting Trends and Techniques" — 1955 edition.

culating the net income of current year but will be charged against income in subsequent years.

2. The specific problem is whether a current reduction of income tax resulting from a claim for capital cost allowances in excess of the amount charged in the accounts as depreciation in a period is to be reflected as an increase in net income for that period.

The deferred credit method suggested by the committee as the technique which will provide adequate disclosure and suitable allocation of income taxes is based upon the principle of matching costs and revenues in the measurement of business income. The committee explained that:

> This principle embraces the rule that expenses incurred in earning revenues are properly chargeable against the income of the period in which the related revenue is reflected in the accounts. The matching process is not concerned with the time at which the expense becomes payable. Instead, it is a process of allocating expenses to the period in which the associated revenue is recognized. Canadian corporate income taxes are of such a character that, in appropriate circumstances, they may properly be allocated to the periods affected.

The financial statements for the year ended in 1954 were the first to reflect the circumstances subject to recommendations in Bulletin No. 10. However, as the bulletin was released in November 1954 a substantial proportion of the statements were prepared without the assistance provided by the committee's suggestions. Tables 20 and 39(e) of "Financial Reporting in Canada" summarize the procedures followed in the 1954 statements in dealing with the problem of tax allocation.

In order to secure some indication of the general reception given the committee's suggestions by Canadian accountants, particular attention was paid to the treatment of current tax savings in the 287 statements for 1955 analyzed to date. To determine those statements to which the discussion of Bulletin No. 10 might apply, the consideration of income taxes in the statements of profit and loss were segregated as follows:

Types indicated	*No. of Cos.*
Income tax provision only	249
Income tax provision less tax recovery by loss-carry-forward	5
Income tax recovery only—loss-carry-back	8
No income taxes—loss on operations	13
Not taxable because of loss-carry-forward	3
Not taxable because of additional capital cost allowances	3
No reference to income taxes	
Dominion company	2
Provincial company	4
Total	287

Basis of Current Charge for Income Taxes

Of the 254 statements showing a current provision for income taxes, 175 made no mention of the impact of the application of current tax regulations on the reported net profits and gave no indication of the actual basis of the current charge for income taxes. Accordingly we may assume that the current charge was the amount actually payable in respect of the taxable income for the year. However, because of the lack of information as to the relationship between the capital cost allowances claimed for tax purposes and the depreciation recorded in the account, it was practically impossible to determine with any degree of accuracy whether or not there was a problem of tax allocation.

In 20 cases, it was apparent that the discussion of Bulletin No. 10 did not apply and that the determination of reported net profits was not complicated by a current tax savings. Notes to financial statements, comments in directors' reports and comments in auditors' reports clearly showed that depreciation had been recorded in the accounts at the maximum rates allowable for tax purposes.

The remaining 59 statements clearly disclosed that the taxes otherwise payable had been affected by the application of tax regulations respecting depreciation or similar matters. Of these, 58 reported a current tax saving and one a current increase. The tax reduction was identified in 55 cases with the claiming of capital cost allowances in excess of depreciation recorded in the accounts, in two cases with the deferment for tax purposes of profit on certain conditional sales recorded in the accounts and in one case with excess capital cost allowance and preproduction and development expenditures claimed for tax purposes. The current increase in taxes otherwise payable, noted in the one statement, arose as a result of a portion of the recorded depreciation being disallowed in computing taxable income.

The following table summarizes the treatment given to the current tax savings and increase in the 59 statements disclosing the existence of a tax allocation problem.

Treatment of current tax reduction or increase

	No. of Cos.
Current tax reduction treated as applicable to future years	28
Current tax reduction treated as an increase in reported net profit	29
Current tax reduction treated as a surplus adjustment	1
Current tax increase treated as an application of the deferred credit set up in 1954	1
Total	59

Tax Saving — Applicable to Future Years

The 28 statements, in which the current tax savings was treated as applicable to future years, reflected the application of the deferred credit method recommended by the committee in Bulletin No 10. The current deduction for income taxes in the statement of profit and loss was shown as the amount of taxes that would have been payable if the claim for tax purposes had been the same as the depreciation, profit on conditional sales, and preproduction and development expenses charged in the accounts.

In setting out the deduction for income taxes in the statement of profit and loss, the current tax reduction was shown as a separate item in 12 cases and was included in the current charge in 16 cases. However, the explanations annexed to the statements varied considerably in content and in some cases would not be considered to provide adequate disclosure. The form of presentation and explanations carried have been summarized as shown below.

Disclosure of tax saving and explanation thereof

	No. of Cos.
Current tax reduction set out as separate item in statement of profit and loss	
Amount of excess capital cost allowance disclosed in note to financial statements	3

No disclosure of amount of excess capital cost allowance or excess expenditures claimed	9
Current tax reduction included in charge for income taxes on statement of profit and loss	
Amount of current tax reduction disclosed in note to financial statements – amount of excess capital cost allowances not shown	11
Amount of current tax reduction set out in directors' report—amount of excess capital cost allowance not shown	1
Amount of both current tax reduction and excess capital cost allowances set out in note to financial statements	2
No disclosure of amount of current tax reduction or profits deferred	2
Total	28

In one statement indicating an increase in the taxes otherwise payable, the current deduction for income taxes in the statement of profit and loss was set out as shown below in "A".

The portion provided in a prior year was transferred from the "deferred liability re taxes on income" which had been set up in 1954 in the surplus adjustment shown in "B".

The circumstances reflected in the 1955 statement of this company provides an illustration of one of those "future periods in which the amounts claimed for tax purposes will be less than the depreciation recorded in the accounts" referred to by the committee in recommending that the determination of reported net profits should be based upon the principle of matching revenues and costs. The treatment followed in this case was in line with that suggested in Bulletin No. 10 for such circumstances.

Of the 287 balance sheets analyzed for 1955, 32 showed a deferred credit

"A"

Taxes on income		
Taxes payable for the year	$47,066.42	
Less portion provided in a prior year (Note 3)	5,074.75	$41,991.67

Note 3: As a result of the sale of fixed assets at a profit in a prior year depreciation in respect of certain remaining assets is not allowable for tax purposes. Additional taxes payable in respect of the current year as well as the estimated additional taxes which will arise in the future from such disallowances were provided for at the time of sale and shown in the balance sheet as a deferred liability.

"B"

Profit on sale of fixed assets		$1,933,151.49	
Less (see Note):			
Estimated income taxes payable thereon	$110,940.02		
Provision for estimated additional income taxes	43,573.28	154,513.30	1,778,638.19

Note:
As a result of the sale of the major portion of the companies' fixed assets during 1954, a tax estimated at $110,940.02, as shown above, is payable in respect of depreciation recapture, and in future depreciation in respect of certain remaining assets will be disallowed for tax purposes. It is estimated that at current rates the additional taxes which will arise from such disallowance will amount to $43,573.28 and this amount has been set aside as a deferred credit in the balance sheet.

or reserve for income taxes applicable to future years. This total included the 29 statements referred to above and one statement in which there were no taxes currently payable because of excess capital cost allowance but which included a charge in the statement of profit and loss for the current tax savings (referred to on page 548). It also takes in one statement in which the deferred credit method was adapted in accounting for a loss-carry-back credit. This presentation will be dealt with in detail in the discussions relating to Bulletin No. 12. In the remaining case, the company suffered a loss on the 1955 operations and the deferred credit had been set up by the following earned surplus adjustment:

Recovery of Income Taxes for 1953 and 1954	$300,000	
Less: Transfered to Future Tax Reserve (Note 1)	139,600	160,400

***Note* 1:**

Reserve for Future Taxes

In submitting its 1954 Income Tax Returns the Company claimed Capital Cost Allowances greater than the provision for Depreciation charged in the accounts for that year, thereby converting the 1954 profit into a tax loss. Arising from this the provision for Income Taxes charged in the 1954 accounts was not required and the Company was able to reclaim the greater portion of 1953 taxes.

The additional allowances claimed resulted in tax values of fixed assets as at 31st December 1954 being reduced below the corresponding net book values by $297,000 and $139,600 representing the equivalent of Income Tax at the current rate on this amount has been transferred to a reserve for Future Income Taxes.

In all cases the taxes applicable to future years was set out as a separate item on the liability side of the balance sheet before the shareholders' equity section. There was quite a variety in the terminology used to identify this figure. In nine cases the wording recommended in Bulletin No. 10 "Accumulated Reduction Applicable to Future Years" was used. In 14 cases the balance was described as a "reserve" or "provision". In the remaining balance sheets descriptions such as "accumulated tax reductions arising from additional depreciation allowed", "tax reduction applicable to future years", "deferred taxes on income" and "deferred credit in respect of income taxes payable in future years" were used.

In three cases, in addition to the transfer relating to a current tax reduction, the deferred credit was increased by a surplus adjustment made to adjust the accounts to reflect similar tax reductions realized in prior years.

Tax Saving — Increase Net Profits

In the 29 statements in which the current tax saving was reflected as an increase in the reported net profit, the current deduction in the statement of profit and loss was the amount of taxes actually payable. The committee recognized this treatment but considered it acceptable only if adequate disclosure was made of the effect of the reduction of the taxes payable on the reported net profit for the year. Unfortunately in some of the reports, the explanations provided were not what could be considered adequate and it was

impossible to determine how much the reported net profits had been increased. The following summarizes the explanations carried in the statements following the alternative treatment:

Details of explanations relating to current tax saving

	No. of Cos.
Amount of current tax reduction and of excess capital cost allowances set out in note to financial statements	10
Amount of current tax reduction and of excess capital cost allowances set out in directors' report	2
Amount of current tax reduction only set out in notes to financial statements	7
Amount of current tax reduction only set out in auditors' report	1
Amount of excess capital cost allowance only set out in notes to financial statement — no disclosure of current tax reduction	4
Amount of excess capital cost allowance only set out in directors' report — no disclosure of current tax reduction	3
Net property value subject to future capital cost allowance set out in note to financial statements — no disclosure of current tax reduction	2
Total	29

TAX SAVING — AN ADJUSTMENT OF SURPLUS

It is extremely difficult to understand the purpose of the procedure adopted in the one statement where the current tax saving was treated as a surplus adjustment. The statement of earned surplus set out the adjustment (debit) shown below.

In this case the deduction for income taxes in the statement of profit and loss was the amount that would otherwise have been payable if capital cost allowances for tax purposes had been the same as the depreciation recorded in the accounts. So far this treatment followed the pattern of the principle of matching costs and revenues. However, the current tax savings was not considered to be a deferred credit to be applied in the determination of income of future years but rather an adjustment of earned surplus. In other words although the currently reported net profit was reduced by the amount of the current tax savings, such a reduction was restored to earned surplus, thereby contradicting part of the charge against income.

In this particular case the net effect of the current operations in the earned surplus is the same as it would have been if the depreciation charged had been equal to the capital cost allowances claimed.

Taxes Payable Eliminated by Excess Capital Cost Allowances

The disclosure technique used in the three cases in which it was in-

Capital cost allowances in excess of normal provision for depreciation (Note 5)	$4,350,000	
Less: Resultant reduction in income taxes	2,100,000	
		2,250,000

Note 5:
Capital Cost Allowances:
The provision of $5,498,681 charged to operations for the year represents approximate normal depreciation. The amount of $4,350,000 charged to earned surplus represents additional capital cost allowances under the income tax regulations. As a result, 1955 income taxes payable have been reduced substantially, the resultant reduction being subject to acceptance by the taxation authorities.

dicated that current taxes payable had been eliminated by claiming excess capital cost allowances varied. In one of these reports, the following note was attached to the statement of profit and loss: "No income taxes are payable on the profit for the period due to application of a portion of the depreciation written off in prior years and not claimed for tax purposes." A note to the financial statements, in one other case, noted that: "It is the Company's intention to claim for income tax purposes approximately $85,000 of capital cost allowance in excess of the normal depreciation reflected in the above statement." The directors' report included the following comment: "No provision has been made for income taxes for the year under review. Losses in connection with the liquidation of terminated operations, which losses were charged to surplus, together with capital cost allowances relating to fixed assets which have been disposed of, are sufficient to eliminate taxable income for the year. Full normal depreciation has been taken on fixed assets remaining in the possession of the Company." In both of these cases, there was no deduction in the statement of profit and loss relating to income taxes. This treatment presumably is based upon the theory that the measurement of business income should take into account the income taxes actually payable regardless of how such taxes are determined. The current tax savings was therefore reflected as an increase in reported net profits. However, since neither of these reports disclosed the effect of the elimination of taxes payable on the net profit for the year, they have not provided the information which the committee stated was a condition of the acceptability of application of this theory.

In contrast, the remaining report recognized the deferred credit method recommended by the committee and the current tax saving was treated as applicable in the future years. The statement of profit and loss set out the following:

Profit for the year	$769,325
Less:	
Appropriation as a reserve for future income taxes	275,000
Balance for the year carried to Surplus	$494,325

Notes: [attached to the profit and loss statement]

1. Through the application of the capital cost allowance provisions of the Income Tax Act, income taxes, which would otherwise have amounted to $342,000, are not currently payable. An appropriation of $275,000 has been made as a reserve for future income taxes which will be applicable to those periods when capital cost allowances will be less than the depreciation recorded. Also, income tax provisions in prior years, likewise not currently payable, have been transferred to the reserve for future income taxes.

It is impossible from the information provided to determine why the current appropriation to the reserve for future income taxes was not the full amount of the taxes currently eliminated — $342,000.

(In February a comparison will be made of the techniques used by Canadian accountants in accounting for loss-carry-over credits with the treatments suggested in Bulletin No. 12.)

BY KENNETH M. PLACE, C.A.

Administrative Accounting

Inventory Controls

With the ever-increasing ramifications of modern business, proper control of inventories becomes more important and also more complex. Essentially, however, there are two main factors which must be evaluated before designing a proper system of inventory controls, i.e. the degree of physical control necessary to ensure availability of adequate stocks and to safeguard them, and the degree of financial control necessary to ensure the most efficient use of the investment involved. A major exercise of judgment is involved in relating the cost of achieving certain objectives to the possible benefits to be derived from these objectives. Since the weight given to the various components will differ from case to case, the discussion here will be restricted to the main elements of the problem and the relationship between these two factors.

While their relative value may vary from industry to industry and from business to business, inventories are essential to the conduct and success of practically every commercial enterprise today. In a retail sales business their importance is overpowering; in a service organization, such as an advertising or insurance agency, they are largely secondary; yet in both there is the necessity for some degree of control.

Naturally the degree of control will be governed by the size and value of the inventories concerned. The first step which must be taken, therefore, is to assess the magnitude of the problem. Consideration must be given to such factors as:

1. Total value of inventories.
2. Unit value of components.
3. Convertibility.
4. Sources of supply.
5. World supplies and markets.
6. Average time required to replace.
7. Type of inventory, i.e. raw material, supply, finished goods, etc.
8. Location.

These factors will also vary from business to business, and in specific cases there may be others of even greater importance. However, they will serve to illustrate the relationships which must be considered in determining inventory policy and establishing controls.

Obviously the most important thing is to have a supply of the materials essential to carry on the business always available at the location where they are needed. Any system which may cause a shut-down because of an inventory shortage must necessarily be rejected. On the other hand, a system which permits excessive stocks to accumulate also fails to perform one of the essentials of proper control, i.e. the maintenance of proper inventory levels. Accordingly, the first step should be to establish standards for all types of inventories. Usually, this can best be done by the joint action of representatives of the manufactur-

ing, selling, purchasing and financial units of the organization. The manufacturing or selling representative should assume the major responsibility depending upon whether the item concerned is required for a manufacturing operation or is to be sold. In order to be fully effective, these standards must be flexible enough to allow for changing conditions, and should be reviewed periodically to ensure their continued validity.

Once standards have been set, the next step is to devise a procedure to enforce them. Here the accountant must play a major role since this is basically a problem of recording and reporting to management. Up to this point, the greatest stress has been laid on the overall economic factors, that is the establishment of proper inventory levels compatible with efficient operation of the sales and manufacturing functions. Now, however, the physical aspects of inventory control must be studied and related to cost. Thus, the system for physical control must permit correlation with the established inventory standards with the minimum of effort commensurate with adequate physical security. In order to accomplish this, a fine balance between a number of variables is essential. Probably the first step is to determine what safeguards against misappropriation are necessary. Naturally the more valuable and portable an object is, the greater should be the degree of protection. To use an example, platinum must be handled differently from coal. Again, frequency and location of use have an important bearing. If an item is used frequently in small quantities in one particular area, consideration should be given to issuing it in larger quantities so that a stock can be maintained at the point of use. Time will be saved and paper work reduced by not having to make frequent trips to a central inventory location.

The most important area in the design of an accounting procedure to control inventories is the relation of cost to the benefits to be realized. The accountant, then, must first know what costs are involved. The most obvious, of course, are the direct expenses, such as storekeepers, inventory control clerks, stationery and similar items. There are also a number of others, such as the investment in space, overhead (heating, overall supervision, etc.), distribution, waste time in filling requisitions, etc.

In recent years there has been a trend toward simplification not only of inventory accounting procedures, but also of purchasing practices. The degree of dollar control exercised over minor inventory items has been streamlined. In the area of stores and supplies, for instance, many companies now charge the total dollar value of all items having a unit value of less than a predetermined amount to costs as soon as the material is received. Thereafter, the only records kept are in terms of quantity and are used almost exclusively to ensure that adequate stocks to maintain production schedules are available.

Another variation is the establishment of sub-stores in the various production departments, particularly where the plant concerned covers a large area. Here again, no dollar control is generally exercised once the item has left the main stores location. One of the problems encountered in any system where charges to operations are not based on actual consumption is compatibility with tax requirements. This can usually be overcome by taking an actual inventory count once a year and making any

necessary adjustment to profits on this basis. However, the more accurate the dollar and quantity accounting records are, the more expensive they are going to be to maintain. Thus, the problem boils itself down at this stage to determining the correct relationship between cost and accuracy, and to designing a procedure to continue this relationship.

It is not always easy to determine the consumption of items. In many instances, materials which are used in bulk constitute a large part of the inventory in terms of value. Here, the volume of consumption and in many cases the low unit value make it almost impossible to maintain accurate inventory records. A familiar example is coal. The most common method of measuring this type of consumption is by use of a formula, since actual measurement, either by weighing or in some other manner, is far too expensive. Care must to be taken to make proper allowance for unavoidable losses due to handling, etc. in such a manner that these losses are actually charged against operations in the period in which they are incurred.

Finished goods present other problems. In setting standards, for instance, a completely different set of factors must be considered, including:

1. Stocks in process equipment (due allowance must be made for process time).
2. Stocks unavailable for sale or use due to the need for further aging, blending or testing, e.g. liquor inventories.
3. Reserve stocks held for use in manfacturing operations of other units.
4. The amount of stock which must be produced to permit economic production runs and maximum utilization of equipment.
5. The level of stocks which must be maintained at various distribution points and warehouses including those in transit and on consignment.
6. Stocks in transit to customers which have not been invoiced as yet.

Again, once the standards have been determined, the factors enumerated above, i.e. the balance between cost and benefits, must be superimposed before a final procedure can be established.

Thus, the problem of inventory control can be solved by determination of proper economic levels for all inventories and the introduction of physical safeguards and recording procedures necessary to meet these standards and to prevent physical losses. In day-to-day operations, there can be no doubt of the necessity of adequately protecting the investment in inventories against misappropriation and other forms of misuse; from the long-range point of view, however, it would appear that the determination of proper inventory levels can have a more significant effect on operations.

The principles which should be borne in mind when establishing inventory standards are summarized as follows;

1. Standards should represent requirements at the lowest level possible commensurate with the avoidance of greater losses from factors other than inventory, i.e. the level of inventory that will produce the highest return on investment consistent with reasonable

protection to production and sales.

2. Standards should make allowance for adequacy of supply and transportation, and levels of manufacture and sales which are expected to prevail throughout the year. Recognition should also be given to conditions not subject to management control, such as shortages of basic materials, political conditions, car shortages, strikes, etc.
3. Standards should be practical and reasonably attainable.
4. Standards should represent average stocks, not the minimum below which it is unsafe to go, or the maximum which may be reached as a result of receipt of bulk shipments, etc. They should not be considered inflexible and should not preclude taking advantage of favourable purchasing opportunities.
5. Standards should be determined for individual items or groups of related items wherever the dollar value is significant.
6. Standards for investment in each category of inventory should generally be a composite of individual standards weighted according to relative importance.
7. In order to be of most value, they should reflect the combined views of production, sales, purchasing and accounting personnel.

An inventory control system which achieves proper balance between the various factors discussed should produce the maximum return possible on the investment involved.

ON HUMAN RELATIONS

Learning is acquired by reading books; but the much more necessary learning, the knowledge of the world is only to be acquired by reading men, and studying all the various editions of them.

— LORD CHESTERFIELD

BY MELVILLE PIERCE, B.A., LL.B.

The Tax Review

Foreign Exchange Profits

If a person is in the business of buying foreign currency for the purpose of reselling it at a profit, there is no doubt as to the taxability of the profit. The question which does provide the difficulty, however, is where the profit is made on a foreign exchange transaction which is, or is alleged to be, a purely collateral transaction to the real business of the taxpayer. One must look to the cases to provide the basis for resolving the difficulty, and the cases, it must be conceded, do not furnish a ready answer.

In *McKinlay* v. *H. T. Jenkins & Son Ltd.* (1926), 10 Tax Cases 372, the company in question was in the business of buying and selling marble and stone, supplies of marble being obtained by it in Italy. On the occasion now in question a customer ordered a supply of Italian marble for delivery in the future and advanced the appellant company a sum of money in sterling on account of the price. The appellant company, in anticipation of the purchase, at once converted the advance received from the customer into Italian lire though it postponed making the purchase of the marble. Prior to the purchase the lire appreciated in value, whereupon appellant, not unwilling to make a profit, sold the lire for more pounds sterling than it had originally paid. Subsequently, when the time came to purchase the marble, it acquired an additional supply of lire which it used to make the purchase, and its expenditure in acquiring the second supply was allowed as a deduction in computing appellant's trading profit. The Inland Revenue, however, claimed that the profit made on the earlier transaction of purchase and sale was a trading profit and therefore taxable. Mr. Justice Rowlatt, whose reputation as a revenue Judge has never been assailed, rejected the Crown's claim. The profit on the first transaction, he said, was made on a temporary investment of free funds and was not a profit arising out of a contract for the supply of marble. It was, he summarized, simply a speculation in foreign exchange with capital lying idle.

One should perhaps note, as another Judge later pointed out, that the original purchase of the lire was not made with a view to speculation, and it may be that this circumstance affords a basis for doubting the correctness of the decision. It must be admitted that although Mr. Justice Rowlatt's decision in this case has never been overruled some later Judges have intimated doubts whether they would have decided the case in the same way.

In *Landes Bros.* v. *Simpson* (1934), 19 Tax Cases 62, appellant firm was appointed the sole commission agent to sell furs for a certain company. One term of the agency contract called for appellant firm to advance its principal a part of the value of each consignment of furs shipped to appel-

lant for sale. Appellant made the advances in dollars and gained a profit owing to fluctuations in the rate of exchange between the date of the advance and the date when it was repaid and converted into sterling. In this case it was held that the profit arose directly in the course of the firm's business and that it was part of its trading receipts for income tax purposes.

One's observation is that the transaction resulting in the profit in this case was an integral part of the contractual relationship which resulted in the profit, and the case is therefore clearly distinguishable from the *McKinlay* case.

In *Imperial Tobacco Co.* v. *Kelly* (1943), 25 Tax Cases 292, appellant company, which was an English company, followed the practice of purchasing large quantities of U.S. dollars to finance its substantial purchases of tobacco leaf in the United States. Every year it acquired a stock of U.S. dollars for this purpose, but on no occasion did it ever buy dollars for the purpose of resale as a speculation. On the outbreak of war a government regulation prevented further purchases of American tobacco leaf and the company was also obliged to sell its stock of U.S. dollars to the British Government. The sale produced a considerable profit, which the Inland Revenue claimed was a trading profit and subject to income tax. It was held by the Court of Appeal that the sale was effected in the course of the company's regular trading operations and that the profit made was accordingly to be included in computing the company's profits for the year. Lord Greene, the Master of the Rolls, characterized the transaction as a sale of surplus dollars which had been acquired for the purpose of effecting a transaction on revenue account, and he said any transaction of this description, whether in dollars or in any other commodity, would be on trading account and so taxable. His Lordship indicated, though he did not explicitly express, some doubt of Rowlatt J's decision in the *McKinlay* case.

In *Davies* v. *Shell Co. of China* (1951), 32 Tax Cases 133, a British company which sold petroleum products in China required its agents in that country to put up deposits as a guarantee that they would meet their obligations. The deposits, which were in Chinese dollars, were ordinarily held by the company in its Shanghai bank, but after the outbreak of hostilities between China and Japan, it transferred the deposits to London and deposited the sterling equivalent with its London bankers. Subsequently the Chinese dollar fell in value with the result that the company was able to repay the deposits to its Chinese agents when their agencies terminated at very much less in sterling than it had originally obtained for the Chinese dollars. It was held by the Court of Appeal in England that the profit was a capital profit and not taxable. Said Lord Justice Jenkins for their Lordships: "If the agent's deposit had in truth been a payment in advance to be applied by the company in discharging the sums from time to time due from the agent in respect of petroleum products transferred to the agent and sold by him the case might well be different." But it was clear here that such was not the case: the deposits were to be held by the company for the duration of the agency and were available to the company in one circumstance only, *viz* if the agent de-

faulted at any time during the term of his agency.

There is one Canadian case involving similar issues, namely *Tip Top Tailors Ltd.* v. *Minister of National Revenue,* decided by Mr. Justice Cameron in the Exchequer Court of Canada in April, 1955. There the appellant company, a clothing manufacturer, acquired sterling to finance its purchases of cloth in the United Kingdom. The sterling was held by appellant's London bankers and out of it the British suppliers were paid. Prior to the fall of 1947 the company always deposited the exact amount of sterling required to meet its creditors' accounts but in November 1947, in the expectation that sterling would be devalued, it changed its policy with a view to making a profit in the event of devaluation. Thereafter it adopted the practice of obtaining a bank loan in sterling to finance its British purchases, with the result that when sterling was devalued in September 1949 it made a profit of $169,000 when it repaid the bank loan at a less cost in dollars than would have been required had it purchased the sterling outright. It was held by Cameron J., reversing the decision of Mr. Fisher in the Income Tax Appeal Board, that the profit was subject to income tax. It was a profit realized in the course of the company's ordinary business, he said; the purchase of sterling was a part of the company's ordinary business, and the purchases of sterling made in 1949 to repay the bank loan were an essential part of an integrated commercial operation, *viz* the purchase of supplies and the payment therefor.

It is clear that this case is distinguishable from the *Shell Co. of China* case, though it bears some similarity to the *McKinlay* case, since in each of them the foreign currency was used for speculative purposes. In the *McKinlay* case, of course, the original supply of lire purchased was disposed of independently of the purpose for which it was acquired, a circumstance which does not obtain in the Canadian case, and this was the basis given by Cameron J. for distinguishing the two decisions.

Finally, one cannot ignore the case of *Eli Lilly Co.* v. *Minister of National Revenue,* which has run the gamut of Canadian tax tribunals. In that case, the appellant company purchased its raw materials from a U.S. supplier over a period of years, and in each year the liability was entered in its accounts as such but not actually paid. During this period the U.S. dollar was at a premium in terms of the Canadian dollar, and appellant entered the amount of the premium each year as a liability. The Minister did not apparently question this procedure (which appears to be quite unexceptionable from an accounting viewpoint anyhow), and in each year the company was allowed a deduction of the full amount of the liability, including the premium, in computing its Canadian tax. Then, in 1946, the Canadian dollar rose in value in terms of the U.S. dollar, whereupon the company paid off its full liability to its U.S. supplier at a considerable saving in Canadian dollars. The Canadian courts, ITAB, Exchequer Court and Supreme Court, held that the saving was a taxable profit and subject to income tax. In the first of these courts Mr. Fisher, who presided, was of the opinion that the saving effected was taxable because it was clearly connected with the carrying on of the company's business. The President of the Ex-

chequer Court was of a similar view. It was, said Thorson P., a profit from the company's trade or business, and not a fortuitous or capital profit. The Supreme Court of Canada was not unanimous in its view, but three of the Judges favoured the taxability of the sum in question.

In the opinion of the majority of the Court, the obligation of the company to pay its U.S. suppliers in U.S. dollars introduced a factor of uncertainty, whence it followed that until the amount was actually paid the amount set up in the company's books was simply an estimate of what would have to be paid and the amount of the premium was really a reserve for a contingency. Since the Act prohibits the deduction of reserves for contingencies it followed that the premium ought not to have been deducted at all in any of the years it was allowed. The court, however, did not so state. Indeed they could not, for if the premiums should not have been allowed to be deducted in the years in which they were claimed the Minister of National Revenue's correct procedure clearly was to have disallowed the deductions in those years. This notwithstanding, the majority of the Supreme Court held that he was entitled to add the deductions back into the company's income years after they had been claimed and allowed.

The decision of the majority does, therefore, seem to lack logical consistency, and in view of this and the more cogent reasons given by the minority for their contrary view there remains considerable doubt whether this particular decision will be relied on by the court which pronounced it in any subsequent case which is not on all fours with it.

The judgment, to those accountants who have given it serious consideration, must be rather appalling also for its implicit rejection of accepted accounting principles respecting the computation of business profits. One is led to cite the following passage from a recent judgment of the House of Lords, which is not irrelevant to this discussion:

> When a trader in the course of his trade receives a new and valuable asset, not being money, as the result of sale or exchange, that asset, for the purpose of computing the annual profits or gains arising or accruing to him from his trade, should be valued as at the end of the accounting period in which it was received, even though it is neither realized nor realizable till later. . . . If the asset is difficult to value. . . . the best valuation possible must be made.—Viscount Simons in *Gold Coast Selection Trust Ltd.* v. *Humphrey* (1948), 30 Tax Cas. 210 at p. 240.

Similarly when a trader incurs an obligation payable otherwise than in the currency of his own country, does it not follow that that obligation for the purpose of computing his annual trading profit should be valued in precisely the same way?

BY PETER C. BRIANT, B.COM., C.A.

Current Reading

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MAGAZINE ARTICLES

ACCOUNTING

"Let's Develop Return-on-Investment Consciousness" by G. W. Frank, *NACA Bulletin,* October 1956, pp. 200-207.

Over the years, industrial accountants have been fairly successful in developing cost consciousness among management. Mr. Frank thinks the time has come when accountants should in turn become more aware of the importance of return on investment when preparing figures for management purposes. However, the calculation of return on total investment is, in his view, inadequate as an indicator of the success of an enterprise. "It is quite possible," he writes, "for a product's earnings to appear satisfactory, but to find that these earnings are not resulting in an adequate return on the investment needed to make it possible." He therefore urges all accountants to develop ways of distributing a firm's total investment by products, and presents some specific recommendations as to methods that can be used.

AUDITING

"Audit Objectives: Key to Auditing Standards" by H. F. Stettler. *The Journal of Accountancy,* October 1956, pp. 56-59.

Auditing is a matter of research, and the initial step in almost every audit is the formulation of the hypotheses to be accepted or rejected on the basis of the evidence gathered. The profession has spent a great deal of time studying auditing standards; strangely enough, nothing has been done to develop a sound body of audit objectives.

In a statutory audit the major objective of the auditor is to report to the shareholders. Mr. Stettler agrees that this is an important goal to have established, for auditing procedures then become merely a logical means of collecting the evidence necessary to form an opinion on the statements presented. But Stettler would also like to see the profession formulate subsidiary objectives for each account studied. He suggests that the work should embrace three major areas: internal control, standards of accounting and corroboration of amounts shown in the financial statements.

One cannot help thinking that here is a useful approach to the development of audit programs in practice. A questionnaire as the basis of data-gathering might well present a greater challenge and prove to be more stimulating to junior accountants than the mechanical performance of a list of procedures. It would also help them to acquire the research approach, which is such an important aspect of auditing.

The formulation of a sound body of audit objectives is a problem to which our own Committee on Accounting and Auditing Research might well direct its energies. In the meantime, students preparing for auditing examinations could do no

better than to develop their own set of hypotheses for each item of significance on the financial statements. Procedures should then be worked out to satisfy the objectives listed. Stettler illustrates an approach that might be used in the examination of accounts receivable, and submits a list of suggested audit objectives for other accounts.

FINANCE

"INVESTMENT IN STOCKS AND SHARES" by G. H. C. Touche. *The Accountant*, September 22, 1956, pp. 279-284; September 29, pp. 311-316.

In this remarkably comprehensive survey of investment fundamentals, Mr. Touche discusses investment risks, the choice of securities, buying and selling, sources of investment information and investor psychology.

Here is a man who, as an accountant, apparently looks with some favour on the monetary stability associated with the international gold standard. Nevertheless, he recognizes that full employment is now an acceptable goal of government policy and that the rigidity of money wages is likely to continue. He concludes, in consequence, that the currency will probably continue to bear the brunt of economic fluctuations in the future and that many of our traditional investment standards must therefore be changed. Fixed interest securities, for example, are no longer suitable as a long-run investment, he states.

In addition to the risks traditionally associated with commercial activity and the stock market, Mr. Touche finds the increase in the power of the state in the last 50 years has made it necessary for the modern investor to allow for political risks in his calculations. Typical examples of the economic actions of some governments are listed: the nationalization, denationalization and threatened renationalization of industries; the control of internal and external trade; and the persecution of capital. In this regard, the author states that its social, political, and economic climate makes Canada a particularly favourable investment outlet.

The essence of Mr. Touche's comments is summarized below:

1. Both investment and non-investment in an age of inflation involve the risk of loss of capital.
2. Do not invest in countries which persecute capital.
3. Invest in well-managed companies in growing industries in an expanding economy.
4. The absence of a market for stocks or bonds greatly increases the risk.
5. Do not buy fixed interest securities for permanent investment.
6. In the choice of investments, the needs and situation of the investor are at least as important as the nature of the investments.
7. The size of the individual risks taken should be proportional to the size of the fund available for investment.
8. The best safeguard against loss is a proper diversification of the portfolio between bonds and stocks, between industries, and between companies.
9. To offset the risk of capital loss, a proportion of the fund should be invested in stocks with a probability of growth.
10. It is costly to fidget with your investments.
11. Do not buy on a falling market; do not sell on a rising market.
12. Cut your losses; run your profits.
13. Make your decisions in cold blood and do not be hustled.

"FINANCING A DECADE OF CORPORATE INVESTMENT", *The Bank of Nova Scotia Monthly Review,* September 1956.

In the decade 1946-1955, Canadian

corporations are reported to have invested \$24 billions in new fixed capital goods and in inventories. Almost one-third of this investment has been financed out of retained earnings. Depreciation allowance of \$11 billions have been the other major source of funds. The Review notes that corporate depreciation charges are now almost three times the 1946 rate of \$500 millions.

New corporate issues of bonds and stocks are said to have exceeded \$4 billions in the years 1946-1955. Of this amount, 60% was raised through bond issues; stock issues accounted for the other 40%.

The Review warns that the great post-war emphasis on internal financing means that many business investment decisions are not subject to the test of the stock market, and that over-expansion of capital facilities may result. It also believes that the relatively limited supply of equity securities has been an important influence in the post-war rise of stock market prices.

PENSION SCHEMES

"PENSION SCHEMES – THE TWO METHODS" by An Actuary, *The Accountant*, August 18, 1956, pp. 151-156.

"FINANCING PENSION BENEFITS" by H. J. Ackerman, *Harvard Business Review*, Sept.-Oct. 1956, pp. 63-74.

"ACCOUNTING FOR PENSION COSTS" by K. W. Perry, *The Illinois C.P.A.*, Autumn 1956, pp. 48-52.

"ACCOUNTING FOR COSTS OF PENSION PLANS." *Accounting Research Bulletin No. 47*, The Committee on Accounting Procedure of the American Institute of Accountants.

The extent of the literature on the subject is a measure of the increased emphasis placed on industrial pension plans. In any event, accountants are well aware that the methods of establishing, operating, and financing pension programs are issues in collective bargaining, and that new problems have arisen in the accounting treatment of labour costs.

In the first two articles cited, the major features of insured and self-administered plans are reviewed, and executives are advised on choosing between the two.

The actuary stresses the importance of recognizing the impact of inflation on the adequacy of pension funds. Whatever the nature of the scheme, he writes, the increase in pensions resulting from inflationary pressures necessarily means that more money must be put aside for pension purposes. In the case of the self-administered fund, the additional liabilities attributable to inflationary salary adjustments are often deferred, resulting in the deficiencies that frequently occur in these funds. The additional cost certainly cannot be avoided under the insured scheme, but the additional liabilities are identified by the insurance company as they accrue and are taken into accounting in accruing premiums.

The author suggests that an employer can avoid the costs of inflation by fixing in advance the percentage of salary to be applied to the fund, and allowing the contributions to buy what they will in terms of pension. But even here, he writes, pensions may become so inadequate that compensatory payments may have to be made at the employer's expense.

Both writers agree that a private fund is not to be recommended for a firm with less than 100 employees. In a small sample, the possibility of

random fluctuations is too great; the investment possibilities are rarely as profitable as those of a large fund; and administrative costs are relatively high. Ackerman suggests that, for the small firm, individual insured policies are the most satisfactory method of providing for pensions.

Ackerman discusses mortality, interest earned, administrative expenses, and employees turnover as the most important factors affecting the cost of a plan. A differential of ¼ of 1% in the earned interest rate, for instance, will produce a differential of around 6% or 7% in the long-run costs of the plan. It is also worth noting that costs decrease by about 5% with every increase of 5 years in retirement age.

In an article devoted solely to accounting aspects of pension funds, Mr. Perry expresses his strong dissatisfaction with the use of footnotes to financial statements as a means of reporting information regarding pension costs. To illustrate the abuse of the footnote, he points to the case of a company with $798,000,000 net assets reporting in a footnote an increase in its unfunded past service pension liability from $49,500,000 to $130,000,000. Currently acceptable methods of accounting for past service pension costs in funded and unfunded phases are reviewed. Perry concludes that the problem of matching appropriate costs and revenues in accounting for pension costs requires additional study by the accounting profession.

Accounting Research Bulletin No. 47 considers the accounting treatment of past service and current service pension costs, and the disclosure of pension fund commitments in the financial statements. The committee reaffirms its belief, expressed in an earlier bulletin, that past-service pensions costs should be charged against current and future operating income rather than to earned surplus at the inception of the plan. It further states that additional charges required to bring an existing plan up to actuarial requirements may appropriately be charged to earned surplus at the time of the adjustment. Six members of the committee object to this latter opinion.

BOOKS RECEIVED

"Manual of Departments and Agencies of the Government of Canada" by Quain, Quain and Quain. Butterworth and Co. (Canada) Ltd., $10.75 [To be reviewed]

"Accounting in the Federal Government" by E. Kohler & H. Wright. Prentice Hall; pp. 291; $5.50.

Addresses of Publishers

[The] *Accountant*, 4 Drapers' Gardens, Throgmorton Ave., London, E.C. 2.

Butterworth & Co., (Canada) Ltd., 1367 Danforth Ave., Toronto 6, Ont.

Harvard Business Review, Gallatin House, Soldiers Field, Boston 63, Mass.

Illinois C.P.A., 208 LaSalle St., Chicago 4, Ill.

NACA Bulletin, 505 Park Ave., New York 22, N.Y.

Prentice Hall, Inc., 70 Fifth Ave., New York 11, N.Y.

BY J. E. SMYTH, F.C.A.

Students Department

Associate Professor, Queen's University

NOTES AND COMMENTS

The other day we were talking about the problem of reading effectively and one of those in the group happened to use the somewhat graphic term, "gutting a book". We realized of course that he meant the reader of the book had extracted from it every last bit of the knowledge it had to offer; but we took it as a further tribute to the genius of books that they can be thus "gutted" and yet not be destroyed for other, later readers.

* * * * *

An approach to studying which we have not mentioned before, and which was brought out in this conversation, is that one should not start to read a book, or a chapter in a book, without first asking himself what he expects to learn from such a reading. The difference between effective reading and ineffective reading is that the effective reader approaches the material with a view to finding the answers to certain questions which he has already formulated in his mind. He asks himself first, before he begins to read, "What do I expect to find out from this chapter?" and "What kinds of questions may it be going to answer for me?"

It is well worth our while to take the extra bit of time required to formulate what we expect to learn from a specific reading assignment before we set about a study of the material. We have all experienced the elation of going to a book for the answer to a particular question and discovering how quickly and efficiently we came to the heart of the book; we have all experienced (perhaps more often) the languor, the lethargy, the waste of time, in reading passively and without purpose, or, perhaps, in reading only from a sense of obligation.

Even when we know very little about the topic covered in a chapter or an entire book, it is still a useful exercise to ask ourselves before we begin to read, "Is there anything at all I know about this subject?" Of course, as we begin to read, other questions should present themselves for an answer at some subsequent point in the reading; we should be continuously curious as we read. Indeed, if we come to the time when we can no longer think of any questions which the material at hand can answer for us, we have probably also come to a time when we should put the book down — either for the time being or permanently.

In her little book "A Modern Elementary Logic" Susan Stebbing has made this point in a single sentence: To be in a questioning frame of mind is to be thinking.

* * * * *

Another technique of studying which we have found helpful, and which now occurs to us as being related to the idea expressed above, is the practice of making notes on a separate sheet of paper as one reads.

This device forces a discipline on the reader: he must express in his own words the ideas contained in the reading. In the process of doing so, he may well find that there are gaps in his understanding which he did not recognize in his reading; and he thereupon returns to the book – in a questioning frame of mind – to find the answers.

* * * * *

Perhaps by now some alert readers will have been experimenting with the very technique we have been recommending by trying to apply it to *these* notes and comments. If so, they may have been asking such questions as, "Are there any kinds of books to which this approach would not apply?" Personally, we doubt that it would apply with much force to works which purport to supply aesthetic enjoyment or inspiration rather than knowledge (e.g. poems, and hymns of praise). But we think that books on accounting and related subjects come within neither of these categories.

Since we have all probably drifted into day-dreams when we are supposed to be studying a book, it may amuse us to consider the difference between day-dreaming and thinking. A day-dream, the philosophers tell us, is an uncontrolled movement of ideas or images through the mind. It may start innocently enough with some routine impact on the senses—say, the sound of a fire siren; and then one image follows another until we have quite forgotten about the fire siren, and are recalling a perfectly pitched world series baseball game (only the last part of which we watched on television because of the slow service in the restaurant next door to the fire station). By contrast, when we are thinking we insist upon a controlled movement of ideas or thoughts through the mind – the kind of attitude which is kept alive and stimulated by a desire to find answers to the questions we have before us. Is the editor being presumptuous in assuming that some readers may occasionally have day-dreamed, as he has, when reading a book on accounting?

PROBLEM 1

Intermediate Examination, October 1955

Accounting II, Question 3 (25 marks)

The following balance sheet was prepared by the accountant of the J Co. Ltd. which was incorporated under the Companies Act (Canada):

J. CO. LTD.

BALANCE SHEET

as at 3st December 1954

ASSETS

Cash	$ 45,000
Accounts receivable	95,000
Investments	250,000
Inventories	225,000
Land, buildings, machinery and equipment	465,000
Deferred charges	10,000
	$1,090,000

LIABILITIES

Accounts payable and accrued charges	$ 113,600
5% first mortgage bonds maturing in 10 equal annual instalments, commencing 31st March 1955	100,000
Reserves	310,000
6% cumulative preferred shares of $10 each	85,000
Common shares of $10 each	380,000
Surplus	101,400
	$1,090,000

During the course of his audit of the accounts for 1954, CA, the shareholders' auditor, discovers the following:

(i) Cash is made up of:

Cash on deposit with X bank	$100,000
Loan from Y bank secured under Section 88 of the Bank Act	55,000
	$ 45,000

(ii) Accounts receivable include consignment accounts totalling $20,000 which have been credited to sales. The cost of these goods is $15,000.

(iii) Investments are made up as follows:

Marketable securities	$ 25,000
Investment in Z Co. Ltd. – a wholly owned subsidiary	125,000
Advances to Z Co. Ltd.	100,000
	$250,000

(iv) Purchased materials in transit at 31st December 1954, amounting to $8,000, have not been included in inventory although the liability has been set up.

(v) Materials amounting to $6,000 have been included in inventory but the relative purchase invoices were not entered in the invoice register until January 1955.

(vi) Due to errors in additions and extensions, finished goods worth $25,000 have been valued in the inventory at $15,000.

(vii) Land, costing $50,000, is included under the caption "Land, buildings, machinery and equipment".

(viii) Freight and duty amounting to $2,500 in respect of new equipment has been charged to "repairs". Depreciation has been provided on equipment at the rate of 10% per annum on the closing balance in the "equipment" account.

(ix) Deferred charges include $5,000 prepaid insurance and taxes and $5,000 representing legal and other expenses incurred on formation of the company.

(x) Through an error in calculation, the prepaid insurance and taxes have been overstated by $500.

(xi) Accounts payable and accrued charges are made up as follows:

Accounts payable trade	$ 67,000
Accrued wages	5,600
Estimated income taxes payable	41,000
	$113,600

(xii) Bond interest of $2,500 was paid on 30th September 1954 but no provision has been made for interest accrued to 31st December 1954.

(xiii) Included under the caption "Reserves" are the following:

Provision for doubtful accounts	$ 5,000
Accumulated allowance for depreciation	255,000
Reserve for plant extension	50,000
	$310,000

(xiv) No dividends have been paid on the preferred shares since 31st December 1951.

(xv) The surplus figure is made up as follows:

Balance 1st January 1954	$ 92,500
Net profit for year	8,900
	$101,400

Required:

(20 marks) (a) The balance sheet which should be included in the annual report presented to the shareholders, prepared in accordance with good accounting principles.

(5 marks) (b) Schedule showing your computation of the revised net profit figure.

NOTE: *Make any assumptions which you consider necessary in the balance sheet presentation.*

A SOLUTION

(a)

J CO. LTD.

BALANCE SHEET AS AT 31 DEC 1954

ASSETS

Current assets			
Cash in bank		$100,000	
Accounts receivable	$ 75,000		
Less allowance for doubtful accounts	5,000		
		70,000	
Investments, at cost (quoted market value, $35,000)		25,000	
Inventories, at cost			
Raw materials	105,000		
Work in progress	63,000		
Finished goods	90,000		
		258,000	
Prepaid insurance and taxes, at cost		4,500	
Total current assets			$457,500
Investment in and advances to wholly-owned subsidiary			
Investment in shares, at cost		125,000	
Advances		100,000	
			225,000

Fixed assets			
Land, at cost		50,000	
Buildings, machinery, and equipment, at cost	417,500		
Less recorded depreciation to date	255,250		
		162,250	
Total fixed assets			212,250
Other assets			
Organization expense, at cost			5,000
			$899,750

LIABILITIES AND SHAREHOLDERS INTEREST

Current liabilities			
Bank loan (secured)		$ 55,000	
Accounts payable and accrued charges		79,850	
Estimated income taxes payable		41,000	
Instalment on first mortgage bonds, payable 31 Mar 1955		10,000	
Total current liabilities			185,850
Long term liabilities			
5% first mortgage bonds maturing in ten equal annual instalments commencing 31 Mar 1955		100,000	
Less instalment included in current liabilities		10,000	
			90,000
Total liabilities			275,850
Shareholders interest			
Share capital –			
6% Preferred:			
Authorized, 10,000 cumulative preferred shares of $10 each			
Issued and fully paid, 8,500 shares		85,000	
Common:			
Authorized, 50,000 shares of $10 each			
Issued and fully paid, 38,000 shares		380,000	
Paid-in capital		465,000	
Retained earnings			
Balance 31 Dec 1953	$ 92,500		
Add profit for year	16,400		
Balance 31 Dec 1954		108,900	
Reserve for plant extensions		50,000	
Total shareholders interest			623,900
			$899,750

Note: Dividends on the 6% cumulative preferred shares have not been paid since 31 Dec 1951 and are in arrears to the extent of $15,300.

J CO. LTD.

SCHEDULE OF REVISED NET PROFIT
for the year ended 31st December 1954

Net profit before adjustments		$ 8,900
Add: Materials in transit not included in inventories	$ 8,000	
Adjustment due to errors in additions and extensions in finished goods	10,000	
Capitalization of freight and duty on equipment	2,500	20,500
		$ 29,400
Deduct: Unearned profit on goods in consignment	5,000	
Set up of accrual for materials included in inventories	6,000	
Adjustment of allowance for depreciation due to capitalization of freight and duty	250	
Adjustment of prepaid insurance and taxes	500	
Accrued interest on bonds	1,250	13,000
Revised net profit for the year		$ 16,400

Examiner's Comments

The examiner has reported that the most frequent errors were (i) to assume that land had been depreciated with the other fixed assets and (ii) to assume that cumulative preferred dividends were unpaid for the year 1951. In submitting the schedule required in part (b) some candidates gave a computation with insufficient details. A number of candidates prejudiced themselves by reading into the question unnecessary details or assumptions.

PROBLEM 2

Final Examination, October 1955
Accounting II, Question 2 (23 marks)

EDITOR'S NOTE: *We regret very much that last minute printing considerations required the deletion of this problem from the November issue. The Notes and Comments appearing in the Students Department for November contain a discussion of some of the points raised in this problem.*

A and B propose to set up a retail sales and service business. They will each contribute $75,000 cash to provide working capital for the project and are to share profits and losses (after partners' salaries) on an equal basis.

They have asked you for advice as to the advantages and disadvantages of operating the business as an incorporated company rather than as a partnership. On the basis of the results obtained by a similar type of business, they have prepared an estimate of the average annual operating results for the business.

On reviewing the estimates you find that:

(i) Included in the operating expenses of the business are:

(1) Annual salaries: A–$10,000 and B–$15,000.

(2) Secretarial salary to A's wife – $2,200 per annum.

(3) Annual donations to recognized Canadian charitable organizations — $3,500.

(ii) Estimated average annual net profit before consideration of taxes is $45,000.

(iii) Of these net profits, A and B each withdraw an additional $7,500; the balance being retained for use in the business. If the business were incorporated, such withdrawals would be in the form of dividends.

You determine that:

(i) (1) A is a married man, 55 years old with no children.

(2) A's wife has no income at the present time.

(3) A will have no other source of income, since he will invest all his savings in the business.

(ii) (1) B is a married man, 45 years old, with three children aged 12, 14 and 21. All of the children are at school or university and have no income.

(2) B's wife has an annual income of $350.

(3) B's only other income will be from investments as follows:

Interest on Government of Canada bonds	$ 640
Dividends on Oil Producing Canada Ltd. shares	$3,000

Required:

(8 marks) (a) The general advantages and disadvantages of incorporating the business.

(12 marks) (b) Your computations of the taxes payable by A and by B on the basis of the above, where the business is operated as:
(1) a partnership, and
(2) a limited company.

(3 marks) (c) Your computation of the taxes payable by AB Co. Ltd. on the basis of the above where the business is operated as a limited company.

Editor's note: The examination paper included a complete table of federal tax rates for 1954. An excerpt from this table is presented below.

Section 32 (Rates for 1954 — adjusted to include Old Age Security Tax)

(1) The tax payable by an individual under this Part upon his taxable income or taxable income earned in Canada, as the case may be (in this section referred to as the "amount taxable") for a taxation year is:

. . . .

(h) $3,020 plus 40% of the amount by which the amount taxable exceeds $12,000, if the amount taxable exceeds $12,000 and does not exceed $15,000,

(i) $4,220 plus 45% of the amount by which the amount taxable exceeds $15,000 if the amount taxable exceeds $15,000 and does not exceed $25,000,

(j) $8,720 plus 50% of the amount by which the amount taxable exceeds $25,000 if the amount taxable exceeds $25,000 and does not exceed $40,000,

(k) $16,220 plus 55% of the amount by which the amount taxable exceeds $40,000 if the amount taxable exceeds $40,000 and does not exceed $60,000.

. . . .

Section 39 (Rates for 1954 – adjusted to include Old Age Security Tax)

(1) The tax payable by a corporation under this part upon its taxable income or taxable income earned in Canada, as the case may be, (in this section referred to as the "amount payable") for a taxation year is, except where otherwise provided,

(a) 20% of the amount taxable, if the amount taxable does not exceed $20,000, and

(b) $4,000 plus 49% of the amount by which the amount taxable exceeds $20,000, if the amount taxable exceeds $20,000.

A SOLUTION

(a) The general advantages and disadvantages of incorporating the business

Advantages

1. Limited liability will protect the personal resources of A and B in the event of legal action against the company or the bankruptcy of the company.
2. The company will have a separate legal existence which will not be affected by the death of A or B.
3. The company form of organization has more flexibility tax wise. It can accumulate profits and defer tax.
4. A company lends itself to setting up a pension fund.
5. It is easier to arrive at a valuation for the purpose of succession duties.
6. Additional financing is not dependent on a new partner being admitted or the present partners providing additional funds. Additional capital can be raised by the issue of shares without relinquishing effective (majority) control.
7. The directors and management can be retained or dismissed at the will of the shareholders. The partnership form of organization invites the formulation of business policy by the partners themselves, regardless of their abilities.

Disadvantages

1. The limited company is not as flexible as a partnership for the withdrawal of capital.
2. The limited company is subject to additional statutory provisions in the companies act under which it was incorporated.
3. In a limited company more attention must be paid to income tax problems arising from the payment of salaries and dividends.
4. Incorporation involves legal costs, and the limited company may be subject to special corporation taxes and license fees.
5. With each of A and B owning 50% of the shares, a disagreement between them would create an awkward situation.

(b) Taxes payable by A and B where business is operated as a partnership

Income from partnership	*A*	*B*
One-half of profits	$ 22,500	$ 22,500
One-half of donations	1,750	1,750
Salary	10,000	15,000
	34,250	39,250

Portion of wife's salary included in arriving at A's share of profits	1,100	–
Investment income – bonds		640
– oil producing company shares		2,400
	35,350	42,290
Less deductions		
Donations	1,750	1,750
Basic exemption	1,000	1,000
Marital status	250	900
Children	–	700
	3,000	4,350
Taxable income	32,350	37,940
Tax on first $25,000 (including Old Age Security)	8,720	8,720
50% on remainder	3,675	6,470
	12,395	15,190
Notch provision re wife	100	
	$12,495	
Dividend credit – 20% of $2,400		480
		$14,710

Total taxes payable – A	$12,495
B	14,710
	$27,205

Taxes payable by A and B where the business is operated as a limited company

	A	*B*
Income		
Salary	$ 10,000	$15,000
Dividends	7,500	7,500
Investment income	–	3,040
	17,500	25,540
Less exemptions		
Basic	1,000	1,000
Wife	–	900
Children	–	700
	1,000	2,600
Taxable income	16,500	22,940

	A	B
Tax on first $15,000 (including Old Age Security)	4,220	4,220
45% on remainder	675	3,573
Surtax		
A – 4% of ($7,500 – $2,400)	204	
B – 4% of ($10,540 – $2,600)		317.60
	5,099	8,110.60
Dividend credit	1,500	1,980.00
	$ 3,599	$ 6,130.60

Total taxes payable – A	$3,599.00
B	6,130.60
	$9,729.60

Editor's Note:

The question asks only for the taxes payable by A and B. In addition, where the business is operated as a limited company, A's wife will pay tax on $2,200 – $1,000 = $1,200.

(c) Taxes payable by AB Co. Ltd. where the business is operated as a limited company

Profit before income taxes	$45,000
Add back donations	3,500
	48,500
Deduct donations allowed – 5% of $48,500	2,425
Taxable income	$46,075
Tax thereon – 20% on first $20,000	$ 4,000.00
49% on next 26,075	12,776.75
Tax payable by AB Co. Ltd.	$16,776.75

Editor's note: Total taxes payable where business operated as a limited company are:

AB Co. Ltd.	$16,776.75
A	3,599.00
B	6,130.60
A's wife	208.00
	$26,714.35

CORRECTION

In discussing the operation of the "notch provision" in part (b) of the above solution where the business is operated as a partnership, the Notes and Comments for the November issue stated incorrectly that A's wife would not have to pay separate tax on her income of $1,100. We regret this error, and thank the readers who have drawn it to our attention.

NEWS OF OUR MEMBERS

Alberta

Russell H. Purdy, C.A. and Ralph L. Giles, C.A. announce the merging of their practices under the firm name of Purdy, Giles & Co., Chartered Accountants, with offices at 231-8th Ave. S.W., Calgary.

Glendinning, Jarrett & Campbell, Chartered Accountants, announce the admission to partnership in their Calgary office of John T. Tryon, C.A.

British Columbia

Frederick Graham & Co., Chartered Accountants, announce the admission to partnership of Edward J. O'Connell, C.A., Vancouver.

Winspear, Hamilton, Anderson & Co., Chartered Accountants, announce the admission to partnership of Gordon H. Brooker, C.A., Vancouver.

New Brunswick

P. S. Ross & Sons, Chartered Accountants, and G. Kenneth McKenzie, C.A. announce the merging of their practices. Henceforth the combined practices in Saint John will be carried on in the name of P. S. Ross & Sons with offices at 94 Prince William St. G. Kenneth McKenzie will be resident partner.

Ian Macaskill, C.A., has been appointed assistant comptroller — disbursements of Canadian National Railways, Montreal.

Ontario

L. J. Mills, F.C.A., has been appointed assistant comptroller — revenues of Canadian National Railways, Montreal.

H. L. Slater, C.A., has been appointed assistant comptroller — general accounts of Canadian National Railways, Montreal.

Waters and Savage, Chartered Accountants, announce the admission to partnership of Gordon W. Horne, C.A. Henceforth the practice of the profession will be carried on under the firm name of Waters, Savage & Horne, Chartered Accountants, with offices at 11 George St., Brantford and 10 Peel St., Simcoe.

C. W. Leask, C.A. announces the removal of his office to 114 Main St. S., Toronto.

Abe Colman, C.A. announces that he has acquired the professional practice of Louis I. Powell, C.A., with offices at 226 Queen St. W., Toronto.

V. W. Scully, F.C.A., vice-president and general manager of The Steel Company of Canada Ltd., has been elected a director of the company.

R. R. Blake, C.A. has been appointed chief accountant with G. L. Griffith & Sons Ltd., Stratford.

William A. Moorhead, C.A. announces the removal of his offices to Ste. 4, 1454A Yonge St., Toronto.

J. V. Murphy, C.A. and G. E. Murphy, C.A. announce the formation of a partnership for the practice of their profession under the firm name of Murphy & Murphy, Chartered Accountants, with offices at 1720 Lawrence Ave. E., Scarborough.

Grossman, Karp & Co., Chartered Accountants, announce the removal of their offices to Ste. 17, 501 Yonge St., Toronto.

Quebec

Robert C. Berry, C.A. has been appointed treasurer of Trans-Canada Pipe Lines Ltd., Toronto.

Saskatchewan

C. P. DeRoche & Co., Chartered Accountants, announce that henceforth the practice of their profession will be carried on under the firm name of Buchan, Moore, Dunlop & Peters, Chartered Accountants, with offices at 301 Avenue Bldg., Saskatoon.

INSTITUTE NOTES

C.A. CLUB OF OTTAWA

At the annual meeting of the Chartered Accountants' Club of Ottawa, held on October 30, retiring president D. J. McClellan reported on a successful year. The club now has a membership of 215, and during the year six luncheon meetings were held as well as an annual dinner and golf tournament. Prizes were awarded by the club to the three students in the Ottawa area obtaining the highest marks in the final examinations held in October, 1955.

The following members were elected to the executive committee for 1956-57, A. J. Frost, president; E. D. Lafferty, vice-president; T. E. Brown, secretary; M. K. Levinson, treasurer; G. W. Dunn; W. Hogben; S. G. Payne; and E. H. Sharpe.

REGINA C. A. ASSOCIATION

The Association held its first dinner meeting at the Assiniboia Club on November 6. Officers for the coming year are H. D. Rendall, president; J. E. Smith, vice-president; D. E. Cuddington and H. J. Pointer, directors; E. J. Reynolds, secretary-treasurer.

REGINA STUDENTS SOCIETY

The Society has organized a curling league with the schedule commencing November 10. Rinks have been received from Clarkson, Gordon & Co., Deloitte, Plender, Haskins & Sells, Goldie, Hunt & Co., T. E. Robinson & Co., Geo. A. Touche & Co.

QUEBEC STUDENTS SOCIETY

On October 18 new members of the society were welcomed. Mr. Lucien D. Viau, president of the Quebec Institute, gave a short address.

The annual dance was held in the Mount Royal Hotel on October 26 with about 550 persons attending.

ONTARIO INSTITUTE

Audit of Registry Offices: The Committee on the Accounts and Audits of Municipal and Certain Other Organizations has been concerned at the lack of responsibility with regard to the audit of registry offices. Apparently these offices are periodically visited by the Inspector of Legal Offices to determine that the provincial government receives the proper portion of the land transfer taxes. However, no formal audit of the accounts of the Registrar is performed. At the request of the committee, the Council has written to the Attorney General of the Province, suggesting that the appropriate Acts should be amended to provide that the auditor of the county or separated municipality in which the registry office is situated shall audit the accounts of the office.

Municipal Reserves and Allowances: The Council has made a submission to the Minister of Municipal Affairs recommending that the Municipal Act be clarified to provide for doubtful accounts other than reserves for uncollected taxes which are now authorized. Following the submission the president and chairman of the Committee on Municipal Accounts and Audits met with the Deputy Minister of Municipal Affairs on November 8 for further discussion.

OBITUARIES

DANIEL BREITMAN

The Institute of Chartered Accountants of Quebec announces with deep regret the death of Daniel Breitman on October 11, 1956.

Mr. Breitman (B.Com., McGill '49) was born on January 24, 1921, served overseas during World War II, and was admitted to membership in the Quebec Institute in February 1951, after passing the McGill Licentiate Examination in 1950. After obtaining his degree he entered into practice and in 1954 became associated as junior partner with the firm of Henry Dainow & Co., Chartered Accountants.

Mr. Breitman, an accomplished pianist, was vitally interested in his profession and at the time of his death was a lecturer in the accountancy evening courses at McGill University.

The Council and members of the Institute extend their most sincere sympathy to his widow, his eighteen-month old son and to his family.

DOUGLAS L. ROSS

The Institute of Chartered Accountants of Quebec announces with deep regret the death of Douglas L. Ross on October 15, 1956.

Mr. Ross attended Westmount schools and served during World War I with the 35th Battery, Canadian Field Artillery. Following World War I he joined the firm of Clarkson, Gordon & Dilworth in Toronto, transferring to the Montreal branch in 1921. He was admitted to membership in the Quebec Institute in 1926 and became resident partner of his firm. In 1941 he organized the firm of Ross, Frewin & Co., assuming the position of senior partner. This company was merged with Peat, Marwick, Mitchell & Co., in 1951. Mr. Ross retired last September 30.

He was a member of the council during the 1940/42 term and also a director of the Montreal City Improvement League and the Montreal Board of Trade.

To his widow and family, the members of the Institute offer their deepest sympathy.

ERNEST W. ISMAY

The Institute of Chartered Accountants of British Columbia announces with regret the death of Ernest W. Ismay of Duncan, V.I. on September 16 last. Mr. Ismay qualified with the Institute of Chartered Accountants in England and Wales in 1906 and was admitted to the British Columbia Institute in 1913. He was senior partner of the firm of Ismay, Boiston, Dunn & Co., Chartered Accountants, Victoria.

To his survivors the members of the Institute extend their sincere sympathy.

HALL C. CHIENE

The Institute of Chartered Accountants of British Columbia announces with regret the sudden death of Hall Campbell Chiene on September 19, 1956. Mr. Chiene collapsed and died while walking to his home.

Mr. Chiene qualified with the Society of Accountants in Edinburgh in 1898 and was admitted to membership in the B.C. Institute in 1908. The same year he was elected a Fellow and later became president of the Institute. He was a partner of the firm of Buttar & Chiene, Chartered Accountants, Vancouver.

Mr. Chiene was a member of the board of governors of Vancouver General Hospital and a life member of the Vancouver Club. He was a familiar figure around Vancouver race tracks where he served as a voluntary judge.

To his widow the members of the Institute offer their sincere sympathy in her bereavement.

CLASSIFIED ADVERTISEMENTS

Rates: ***Positions wanted, $7.00 per column inch; Positions offered, $10.00 per column inch; Open rate, $17.00 per column inch.***

All replies to box numbers should be sent to The Canadian Chartered Accountant, 69 Bloor Street East, Toronto 5, Ontario.

Closing date is 14th of preceding month

REQUIRED by Niagara District firm of chartered accountants; one semi-intermediate, intermediate, or senior student at once. Reply to Box 610.

CHARTERED ACCOUNTANT or 1956 final student wanted for practice in Saskatchewan. Attractive salary plus bonus or profit sharing. Apply, giving experience, to R. L. Bamford & Co. – Scott Block, Moose Jaw, Saskatchewan.

STUDENTS WANTED: Junior, intermediate or senior. Choice of locations; Toronto or other Ontario offices. Apply to G. H. Ward, 200 Bay Street, Toronto 1. EM 4-8589.

CHARTERED ACCOUNTANT AND SECRETARY with 16 years commercial experience desires appointment in Canada, preferably a post where ability and initiative is encouraged. Position as assistant to director or senior executive is envisaged. Willing to undergo initial period of training in Canadian methods. Can attend for interview in Glasgow or London in first instance. Box 608.

PRACTICE WANTED: In Toronto or central Ontario by small firm, willing to associate to retain name. Box 611.

ACCOUNTANT FOR EXECUTIVE POSITION: The School District of Winnipeg requires the service of an accountant holding a degree in accountancy or commerce. Salary $5,000 to $5,500. Promotion to assistant secretary-treasurer within one year if service satisfactory, with salary commensurate with that position. Preference will be given to applicants from 30 to 35 years of age. Reply in confidence, giving complete details of education and experience to F. A. Allden, Secretary-Treasurer, School District of Winnipeg No. 1, corner William and Ellen, Winnipeg.

CHARTERED ACCOUNTANT required by Vancouver firm of chartered accountants with a large and varied audit and taxation practice. Position offers good salary, opportunity to gain experience and future prospects. Apply in writing to Box 612, Our staff has been advised of this advertisement.

CHARTERED ACCOUNTANT WANTED: An expanding firm of chartered accountants located in Toronto requires a young qualified man to assume supervisory responsibilities. This position offers unusual opportunities for experience and advancement. Salary commensurate with ability and experience. Box 576.

RAPIDLY EXPANDING wholesale concern requires recent or expectant graduate in chartered accountancy or experienced senior accountant without degree for position in financial administration with development leading into organizational responsibilities. Salary at going rate. Box 613

STUDENT: Preferably senior – required by C.A. for rapidly expanding practice in Southwestern Ontario. View to management and partnership. Write giving full particulars of experience, standing in course and availability to Box 614.

CHARTERED ACCOUNTANT, Jewish, desires position with public practitioner in Toronto with a view to partnership, succession or ultimate purchase. Box 615.

ATTENTION SOLE PRACTITIONERS: Toronto C.A.'s are interested in sharing their office facilities and/or staff with other small firm. Box 616.

PROFESSIONAL CARDS

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PITBLADO, HOSKIN, McEWEN, ALSAKER, HUNTER & SWEATMAN

Barristers and Solicitors

Hamilton Building, 395 Main Street - - Winnipeg, Man.

STEWART, SMITH, MACKEEN, COVERT, ROGERS, SPERRY & COWAN

Barristers and Solicitors

Roy Building - - - - Halifax, N.S.

ROSS & ROBINSON

Barristers and Solicitors

Canadian Bank of Commerce Chambers - - Hamilton, Ont.

BORDEN, ELLIOT, KELLEY, PALMER & SANKEY

Barristers and Solicitors

25 King Street West - - - - Toronto 1, Ont.

ALAN DIGNAN, Q.C.

Barrister and Solicitor

Bloor Street & St. Clarens Avenue - - Toronto 4, Ont.

PLAXTON & COMPANY

Barristers and Solicitors

Suite 1207, 320 Bay Street - - - - Toronto 1, Ont.

OSLER, HOSKIN & HARCOURT

Barristers and Solicitors

The Dominion Bank Building, 68 Yonge Street - Toronto 1, Ont.

WRIGHT & McTAGGART

Barristers and Solicitors

67 Yonge Street - - - - - Toronto 1, Ont.

BEAULIEU, BEAULIEU & CASGRAIN

Barristers and Solicitors

Kent Building, 10 St. James Street West - Montreal 1, Que.

DIXON, SENECAL, TURNBULL, MITCHELL & STAIRS

Barristers and Solicitors

Bank of Canada Building - - Montreal 1, Que.

LEMAY & ROSS

Barristers and Solicitors

132 St. James Street West - - - - Montreal 1, Que.

McMICHAEL, COMMON, HOWARD, CATE, OGILVY & BISHOP

Barristers and Solicitors

Royal Bank Building - - - - Montreal 1, Que.

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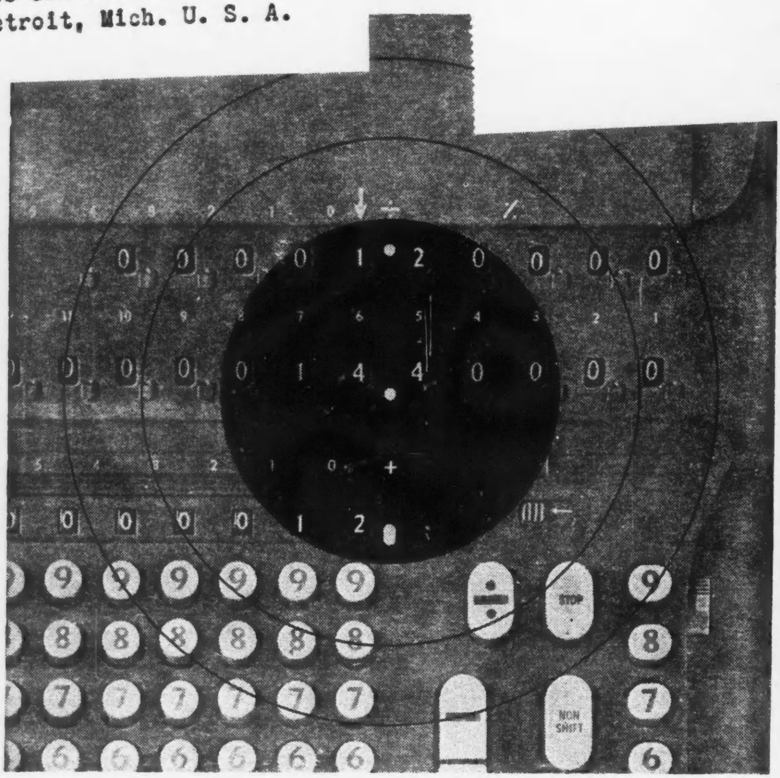

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